

BRIDGING THE GAP:

Cooperative Development Organizations and Private and Voluntary Organizations In Microfinance

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TABLE OF CONTENTS

Executive Summary	1
Major Findings.....	2
Recommendations.....	10
 <u>PART I: TRENDS AND EVOLUTION OF MICROFINANCE AND STUDY METHODOLOGY</u>	13
 Chapter I: Introduction	14
A. The New Field of Microfinance.....	14
B. Business Development Services.....	20
C. USAID Contribution to Microenterprise Development.....	21
D. The Purpose, Design and Methodology of the Study.....	23
 Chapter II: Building CDO and PVO Institutional Capacity in the US to Support Microenterprise Development in Other Countries	26
A. The Role of USAID/BHR/PVC in Strengthening the Grantees.....	26
B. A Look at the Outcomes Resulting from USAID Support.....	29
 <u>PART II: THREE CASES IN MICROFINANCE DEVELOPMENT</u>	38
 Chapter III: The Case of Bolivia: An Advanced Competitive Microfinance Market	40
A. The Local Microfinance Sector.....	40
B. Analysis of a Selected Group of MFIs.....	41
C. The Development of a Level Playing Field in the Local Microfinance Market...48	
 Chapter IV: The Case of Ecuador	52
A. The Local Microfinance Sector.....	52
B. Analysis of a Selected Group of MFIs.....	55
C. Credit Unions in Ecuador: Participation in Microfinance.....	61
D. Lessons, Practices, Areas of Linkages Among MFIs and Key Issues in Microfinance in Ecuador.....	63
 Chapter V: Burkina Faso	64
A. Réseau Des Caisses Populaires Du Burkina (RCPB).....	64
B. The RCPB/Credit With Education Hybrid.....	66
 Chapter VI: Conclusions	75
A. Building a Sector.....	75
B. Credit Unions.....	80
C. Methodological Dissemination.....	81
D. Specific Ways to Improve Cooperation Between NGOs/CDOs.....	82

Chapter VII: Recommendations.....	83
A. Cooperatives.....	83
B. WOCCU.....	85
C. USAID.....	86
D. PVOs.....	87
Appendix.....	89
I. Table to Accompany Chapter III.....	90
II. Cooperative Development Organizations.....	93
Acronyms.....	111
Literature Review and Bibliographic References.....	113

EXECUTIVE SUMMARY

“There is a somewhat uneasy difficult relationship between the PVO/NGO community on the one hand and the cooperative movement protagonists on the other. NGOs, so is argued from the cooperative side, are too much credit delivery oriented, tend to neglect the savings element, and are too donor dependent. From the NGO side, one may hear that cooperatives are too conservative in their lending policies towards the poor, dominated by their middle-class members, and often not well-managed. These are, of course, broad generalizations, and the contexts in which such feelings and experiences are being expressed are very different. In practice, there are many instances in which organizations try to combine the best of the two approaches.”¹

“Credit union or not is not the issue; the quality of the institution is.”

Rich Rosenberg of CGAP in an interview for this study

These two quotes typify the rationale for the study. The PVO and CDO microenterprise sectors have parallel histories and the current field of microfinance has many of its origins in cooperatives. Yet, despite similar antecedents and goals, each side has “myths” and misconceptions about the approach and the methodology of the other. It is clear that “best practice” literature has previously focused on the PVO side, with considerably less written about cooperatives. The purposes of the study therefore were to:

1. Examine the strengths and weaknesses of the cooperative approach;
2. Document the contributions of the CDOs to the field of microenterprise;
3. Identify the current overlaps and hybrids between the PVO and CDO approaches;
4. Improve the communication between the two groups; and
5. Recommend ways to improve USAID support to its PVO/CDO partners.

In addition, the team decided to examine how USAID has built the internal capacity of PVOs and CDOs, and how that, in turn, has built sustainable local institutions with strong outreach. Through its Matching and Cooperative Development grant programs, research and development projects (PISCES, ARIES, GEMINI, AIMS and Best Practices), support for practitioner to practitioner learning (SEEP) and creation of the Microenterprise Office, USAID has been a major contributor to the field. The team’s idea was to look at USAID funds invested in the capacity of a CDO or PVO and what it led to in terms of outreach, performance and sustainability in local institutions.

¹ This quote is from Verhagen, Koenraad. Microfinance a Cooperative Perspective. May, 1998

MAJOR FINDINGS

Competition

One key theme identified by the study is the increasing competition in the microfinance sector that has emerged over the last few years. In Bolivia, where competition has become a major factor (at least in urban areas and the secondary cities where most institutions focus their services) managers are talking seriously about the over indebtedness of their clients who often have micro loans from two, three or even four sources. Clients interviewed for this study were well aware of the many microfinance providers available and the terms they were offering, allowing them to pick and choose between these institutions. A decade ago few of these micro-entrepreneurs would have had access to any institutional source of credit.

Methodology Diffusion

This increased competition has several interesting implications. The most important one, from the standpoint of this study, is the rampant diffusion of methodologies between NGO/PVO projects, credit unions and banks. In the drive for market share and niche, institutions have simply borrowed the best of each other's approaches.

There are numerous examples of methodology diffusion. One involves village banks. FINCA originally established village banks as pre-cooperatives or "quasi-credit unions" to fill a niche for poor women it felt credit unions were no longer reaching. The village banking model spread to a variety of PVOs, including a number of large, multi-sectoral PVOs like CARE and Catholic Relief Services, for which it served as an entrance to the sector.

The methodology was transformed by Freedom from Hunger into Credit with Education. Credit with Education added small, marginal costs onto the village banking methodology to try to educate women on health and family planning issues and impact the end use of income. Many PVOs that had previously only done Child Survival, such as Helen Keller and Project Hope, have borrowed Credit with Education. FINCA, in turn, has started urban village banks and will begin to experiment with individual loans to their most successful clients rather than graduating them.

Freedom from Hunger realized that it needed a sustainable second-tier home for its successful village banks or credit associations. It found one in the credit unions. In Burkina Faso, 49 credit unions are carrying out Freedom from Hunger's Credit with Education (Credit with Education) approach. Credit with Education has grown to serve 30,000 almost entirely illiterate women organized into 1,230 village banks located as far as 35 kilometers from a local credit union office. The credit unions, including the associated village banks, are profitable and use member savings for loans. WOCCU and Freedom from Hunger are now working together to spread this model further.

Credit unions in their efforts to compete in providing products to microentrepreneurs have borrowed methodology from both the commercial banks and solidarity groups. In Ecuador, a WOCCU project has developed 11 products targeted to microenterprises that are now being piloted by individual credit unions. These products came from a close examination of the formal banking sector.

In Bolivia, the largest credit union, Jesus Nazareno has successfully reached urban market vendors through solidarity groups by hiring away Banco Sol staff fully versed in the solidarity group methodology. Jesus Nazareno has disseminated the solidarity group methodology to 10 other credit unions through a WOCCU sponsored workshop. Solidarity groups have served credit unions as a cross co-signer mechanism.

In effect, things had come full circle with the credit unions borrowing back their own creation. USAID's PISCES project documented the solidarity group lending methodology that had been invented by FEDECREDITO, a Salvadorian credit union. Solidarity group lending was introduced to ACCION International, which spread it throughout Latin America, and through Save the Children, another PVO, the methodology was disseminated throughout the Middle East. Many ACCION affiliates, that started as PVOs, evolved into regulated specialized informal sector banks such as Banco Sol from which Jesus Nazareno "borrowed" solidarity groups.

Banco Sol and other institutions providing solidarity group credit, in turn, seeing their best solidarity group clients graduate to individual credit at other institutions, have started to provide individual loans themselves.

Hybridization

Instead of the separate evolution of cooperative, credit union, PVO/NGO and banking approaches over the years, an active process of hybridization is underway. This includes not only the dissemination of methodologies described above, but also the creation of entirely new approaches combining PVO microfinance and cooperatives. The team studied in depth one particularly interesting type of credit union/MFI hybrid, the adoption of the Credit with Education, credit association (village banking) model by credit unions in West Africa to build the trading and market vending activities of poor rural women. The West Africa hybrid experience was a significant challenge because:

- Those served through Credit with Education are extremely poor and illiterate;
- The distance the field staff travels to reach their customers is great;
- The ratio of members to credit agents is high;
- The contact with the clients is relatively infrequent, and;
- The credit association members take a much larger role in managing the group than is the case in large, urban credit unions.

In addition, the Animatrices (extension workers) provide basic nutrition and health education, along with forming, training and supporting the credit associations, and must do much of the record keeping since the women are illiterate.

Now five years old, the credit union federation in Burkina Faso, *Reseau des Caisses Populaires du Burkina* (RCPB) is serving well over 1,000 village “credit associations” with 30,000 poor women members through Credit with Education. The village initiative covers all its operational and financial costs overall, and generates a substantial surplus in areas that have carried out the program for some time.

At the village level these are the factors that have proved important for the successful implementation of the Credit with Education program in Burkina Faso:

- It provides a source of credit that is used to build economic activities at the lowest level that reaches poor, often illiterate villagers in large and rapidly growing numbers.
- It uses a very efficient system for service delivery that can be quickly taught to field staff who can impart skills to the women members while not adding appreciably to costs.
- It builds local leadership and creates new institutions that promote equality for women and children, and provides access to standard credit union services to graduates.

From the perspective of RCPB, Credit with Education has been successful because:

- It increased the surplus of 49 out of 65 RCPB credit unions that adopted it.
- It was fully integrated into the standard savings and credit activities at the branch level and incorporated credit association leadership into the governance of the credit union.
- It delegated decision making for loans to the credit associations, enormously reducing the time consumed for loan review at the credit unions.
- It moved funds from the urban areas where there was excess liquidity, to rural areas where the demand was, generating an important source of revenue for the credit unions.

Contributions of Individual CDOs to the Field of Microenterprise

Since the purpose of the study was comparison between PVO/CDO approaches and CDOs have received relatively less attention in the microenterprise field, the contribution of the CDOs was examined. Each CDO has its own sectoral focus and methodology. WOCCU is the primary financial sector CDO (although ACDI/VOCA, CHF provide significant financial services, and NCBA and Land O’Lakes leverage them). Every CDO, however, had something to contribute to the field.

World Council of Credit Unions (WOCCU)

- A successful credit union methodology based on: 1) the diversity of their client base; 2) an information advantage due to their community foundations; 3) a general ability to supply, simple, accessible deposit services; and 4) a capacity to lend to self-employed clients while obtaining adequate repayment performance;
- A well-developed TA and support strategy;

- Huge scale (more than 20 million credit union members in the developing world); and
- Leadership in the area of small-scale savings mobilization

Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance (ACDI/VOCA)

- Rural finance expertise and approach including maintaining a commercial outlook
- Lending to off-farm microenterprise to diversify risk
- In-depth assessment based on cash flow
- Pricing based on costs and risks
- Longer term loans and close supervision.

This approach has been implemented in transforming several banks and upgrading Agrocapital from a “program” into a successful institution.

Cooperative Housing Foundation (CHF)

- Meeting the challenge of providing credit for housing through assessment tools, training and TA provided to the PVO community;
- Expertise in microfinance not directly related to housing.

National Cooperative Business Association (NCBA)

- Best practices for rural credit intermediation. It has learned some interesting lessons on how to help cooperatives obtain credit in liquidity- starved financial systems with poor repayment records.
- Active involvement in SEEP, which is currently chaired by NCBA’s Vice President of International Programs.
- Providing support to the production and marketing (often export) of non-traditional agriculture.

Land O’Lakes (LOL)

- Equity investment in a local institution in order to ensure a continued stream of technical assistance and adherence to jointly agreed upon operating principles. Sustainability of TA is an issue that many microfinance PVOs are grappling with. As a private sector for-profit business, LOL has much to contribute.
- Sector Analyses which can be shared/done jointly with rural PVOs active in an area
- Knowledge of cross-border market linkages

Americas Association of Cooperative/Mutual Insurance Societies (AAC/MIS)

- Insurance as cutting-edge microfinance issue. AAC/MIS has done USAID-funded surveys of microentrepreneurs that show strong demand for insurance services. ACCION, FINCA and other PVOs are exploring this frontier.

National Telephone Cooperative Association (NTCA) and National Rural Electric Cooperative Association (NRECA)

- The importance of infrastructure to microentrepreneurs. Electricity gives access to power tools that allow producers to make things better, faster and cheaper. NRECA has documented many productive uses. Phones are powerful communications tools useful in business development and marketing. NGOs such as Grameen are now working to extend phone service to the rural poor.

Comparisons between credit unions and MFIs

While there are some commonalities between the various CDOs, there does not appear to be a cooperative approach per se. Given the study's focus on microfinance as opposed to microenterprise, and the huge scale of credit union operations, the primary comparison made was between credit unions and other MFIs. One clear conclusion is that credit unions and other MFIs are becoming more similar. The extent to which and how this has transpired is one of the central themes of this study. It appears that:

- MFIs are moving from a clientele targeted to the poor, to a more mixed clientele. This is to ensure institutional viability and reach greater numbers of people. This change makes them more similar to credit unions that have always reached large numbers of poor people without explicitly targeting them.
- Credit unions driven by market forces and a commitment to the poor, are consciously reaching downward to increase their depth of outreach. This debunks the myth that credit unions are conservative, middle-class institutions which want to keep the "riff raff" out.
- MFIs are adding additional products such as savings, housing loans and insurance that have been offered by cooperatives and credit unions for years.
- MFIs started with methodologies and products for microentrepreneurs, then gradually built institutions. Credit unions came at things from the opposite direction; first building institutions, then focusing on specialized products for the microenterprise sector.

The fieldwork to examine credit union practice relevant to microfinance pointed to the need to recognize that there is no such thing as an average, model, or most common credit union. There are large credit unions and smaller ones; urban and rural ones; rapidly growing ones and those that are barely viable; ones receiving external TA and those that are not. The absence of such a model cautions against the perils of generalizing.

At least for the limited number of credit unions visited, performance compares well with the new credit techniques of microfinance. All had reached significant scale and depth of outreach, and all except the very newest were financially sustainable. In fact, they had reached the most advanced level in microfinance—credit programs fully financed from savings, with interest fees covering their real cost of funds, operations and inflation.

Some credit unions clearly are viable microfinance providers as defined by the types of activities financed, the size of the loans, the type of loan guarantees and loan terms. Credit unions neither exclude the poor nor work exclusively with them. By adopting specific methodologies like solidarity groups and village banks, they can reach vast numbers of poor, marginalized people.

With roughly 20 million members in the developing world, credit unions form an enormous potential delivery system for microfinance. Given USAID's objective of exponentially increasing the number of poor people receiving microfinance services, the possibility of supporting the enormous capacity of credit unions to expand their base to provide microfinance services is a tantalizing possibility. Clear ways need to be found to accomplish this without going back to earlier failed strategies of large sums of external funds going into credit unions for directed credit. Credit unions have a number of inherent advantages as providers of micro-finance services:

- Serving the community is the business of a credit union, so there is a natural congruence between serving the poor and reaching this new market.
- Since credit unions have a community-based structure in place that already delivers savings and credit services, a microfinance initiative can be "grafted on" at comparatively little additional cost. An NGO/PVO or a specialized microfinance bank must develop an entire credit infrastructure from buildings, to staff, to systems and support. In the case of a typical multi-service NGO, there may be the additional issue of having limited experience in the microfinance field.
- Credit unions use the savings of their members to make loans. In some cases, savings from urban areas, where savings exceed loan demand, help fuel economic development in the rural areas where the demand for loans exceeds savings. In contrast, NGO/PVO projects must start with donor funds to make loans, a source of loan capital that is limited and uncertain.
- Credit unions often offer a broader range of products than specialized micro-finance banks or PVO/NGO institutions. In Cooperativa Jesus Nazareno, for example, solidarity group members receive loans for their micro-businesses, and then, using the group, guarantee loans for purchasing a home. The mortgage on the home then serves as collateral for an individual business loan.
- The broader range of clients of a credit union serves as a cushion against losses in one sector. In Burkina Faso, the stable income of urban credit union members helped cover the short-term losses from severe draughts in the rural areas.

Building a Sector

As a donor, USAID has sought to build a microfinance sector in a number of countries. The team tried to answer the question of why Bolivia, one of Latin America's poorest countries, became a hot bed for microfinance innovation. What is unique about Bolivia is that a number of key factors have come together at the right time and in the right way to create a mutually reinforcing process:

- There is a substantial under served informal sector that represents a potential market to be tapped.

- There is economic and political stability that vastly decreases the risk for investing in these businesses.
- The government initially took a hands-off role and then stepped in, at the right time, to create an appropriate regulatory structure.
- The donors, especially USAID, had a clear idea of what their funding and advocacy would support—high quality, large scale, commercially viable institutions that could serve large numbers of informal sector businesses.
- ACCION’s strategy of including high profile Bolivians with considerable clout on the Board of PRODEM helped create a group that could advocate for microfinance with a sophisticated understanding of what they should be advocating for.
- Appropriate, high quality, long term, technical assistance was provided to develop the local institutional capacity to deliver these services at scale and efficiently.
- Tested appropriate methodologies underpinned the process of institutional development so that the institutions developed could reach scale and sustainability.
- A constructive regulatory environment was developed that imposed rigorous performance standards yet did not hinder competition and the search for profits by the practitioners.

All these factors worked together to create the conditions for intense competition among financial intermediaries, leading to innovation, reduced costs and expansion of services outward and downward to increasingly poorer and more rural micro-entrepreneurs. As donors and practitioners work to build institutional capacity to serve the informal sector in other countries, understanding why and how these nine factors worked together to reinforce the expansion of services to the informal sector in Bolivia may provide a useful framework. What occurred somewhat by chance in Bolivia can be translated into a set of interlocking initiatives, or “*Best Strategies*” at the donor level, which should, like “Best Practices” at the institutional level, greatly increase the likelihood of a successful outcome.

In light of what has happened in Bolivia, it is worth reflecting on the genesis of the microfinance sector over the last two decades. When the PISCES team presented their findings in 1980, the two largest initiatives, other than the credit unions, had less than 3,000 borrowers. Yet, these two examples were sufficient to demonstrate that it was possible to reach the poor cost effectively, with almost perfect loan repayment, and with considerable impact.

Since then there has been a remarkable confluence of social mission to serve the smallest economic activities of the poor, combined with a business-like approach for serving them. Now, reaching 3,000 customers is routine, reaching 30,000 should be expected in a few years, reaching 100,000 is not unheard of, and a handful of institutions, almost all in densely populated Bangladesh and Indonesia, are providing financial services to the poor in the millions. All this is being accomplished while achieving operational and even financial sustainability.

In certain markets, principally urban areas, in countries with a well-regulated financial system, under conditions of modest inflation, and political stability, the new “gold

standard” is reaching this market and also turning a substantial profit. In La Paz, Santa Cruz and Cochabamba, a dozen commercial and specialized microfinance banks, cooperatives and regulated NGOs surround a single urban market. The result is market saturation, innovation, increased efficiency and lower costs for the urban consumer.

While a commercially driven approach will doubtlessly become the norm in urban areas, these are hardly the characteristics of much of the developing world. For the rest of the world, an approach driven by a desire to serve the community, to push services down to the poor and out to ever more isolated communities, is more likely to move the field forward, at least for now. The challenge of these mission driven initiatives to achieve this while covering costs, generating a surplus, and expanding rapidly. Many have already demonstrated that this is possible.

USAID Support for CDOs/PVOs

A second important element of building a sector is supporting the PVOs/CDOs that are building the microfinance institutions and supporting microentrepreneurs. A clear conclusion of the study is that the PVC office has transformed organizations through their grant process as well as through the grants themselves. In many cases, the PVOs indicated that the process of applying for a matching grant was one of their more intensive strategy sessions each year. Applying for the grant imposed discipline and focus, and the mandatory evaluations led to enhanced monitoring and evaluation capabilities.

In each case, the PVOs/CDOs interviewed stressed the importance of the PVC grant. This type of funding – directed at institutional capacity building – does not exist elsewhere and without it, the organizations stress, they could not do successful work in the field. In terms of impact, one can see from the data that PVC support had little field impact initially. However, by 1992, the numbers increase almost exponentially. This would illustrate the lag time between infrastructure building and impact and would validate the PVC office’s commitment to capacity building even though the benefits are not immediately quantifiable.

RECOMMENDATIONS

Cooperatives

Each CDO must make a strategic decision on how central microenterprise (and more specifically microfinance) is to their vision/mission/project portfolio. Assuming they want to reach the microfinance market they need to:

1. Become more familiar with the advances in the microfinance field over the last decade and apply them.
2. Explore partnerships with PVOs and NGOs to profitably extend services to the poor and to progressively more rural areas.
3. Get good numbers on the numbers and characteristics of those reached through microfinance initiatives.
4. Get involved in SEEP to improve the exchange of learning between CDOs and PVOs.
5. Hire specialized technical staff with expertise in microfinance.
6. Define a common cooperative approach. If the CDOs want to access donor money as individual institutions, they are already doing it. If they want to do it as a sector they should define what is unique about their approach.

World Council of Credit Unions (WOCCU)

In addition to the recommendations to the broader CDO community above, the following specific recommendations are made to WOCCU

1. Extract lessons learned from credit union microfinance hybrids such as solidarity group lending in Bolivia, and Credit with Education in the Philippines and disseminate the model with FFH and other PVO partners.
2. Continue to strengthen individual credit unions through the model credit union approach, with some flexibility to account for local differences. The model credit union approach, which focuses on the upgrading of the strongest credit unions, is based on the idea that a strong national system first needs strong and sustainable individual credit unions.
3. Learn what to do with non-viable credit unions in the model credit union approach.
4. Continue to work on governance issues.
5. Encourage successful credit unions to join the Microfinance Network. Best practice credit unions compare favorably with any other MFI. By joining MFN, they get a chance to have technical exchange with peers, and join key microfinance discussions.

6. Create its own network of credit unions that provide tailored products for microenterprise. As a group, they could build on their comparative advantages, determine rules of performance, develop a reporting system, and specify standards for the quality of their services.
7. Support the member research/market studies of their credit union partners. Credit unions need to know more about the credit and savings needs of their microenterprise members so they can plan services to meet those needs.

PVOs

1. Pursue natural partnerships with CDOs in areas such as housing lending, insurance for microentrepreneurs, and finding an institutional home for village banking and Credit with Education Programs.
2. Involve CDOs in microfinance forums.
3. Move on the issue of savings mobilization. Attracting savings is increasingly necessary, as external financing becomes scarcer. In addition, savings services are very much in demand by clients.
4. Work on cutting edge issues such as
 - Expanding out to rural areas and to the poor
 - Improving MIS systems
 - Supervision
5. Build Institutions. Many PVOs have been successful in moving from PVO “programs” to sustainable local NGOs. Some have gone further to build institutions that are formally regulated and capture savings. Fewer yet, have established banks. Those PVOs that are still only offering programs or are moving too slowly up the learning curve need to improve their capacity to build sustainable local institutions.
6. Keep sight of depth of outreach at the same time they are working on scope of outreach. They must work on an optimal mix of social mission and institutional viability. While working on massification of programs, they must push to meet the needs of poorer, more rural clients as well.
7. Focus on human capital as an element of success. Many of the Bolivian institutions owe their success to the skills, charisma and political capital of their founders. At an early stage, PVOs must find leaders with the capacity to grow the institution to the full potential the methodology and local context allow.
8. Carefully examine governance issues. Many PVOs are experimenting with equity positions in their partners, representation on their boards of directors and licensing of their name to ensure a continuous flow of TA, provide quality assurance for the methodology and maintain adherence to mission. This emphasis on governance should continue.

USAID

1. **Market the impact of the Matching and Cooperative Development grants with help from the PVO/CDO community.** All respondents interviewed spoke of the importance of the PVC grant in building their institution's capacity in the sector. In addition, data from the local institutions supported by grant recipients shows tremendous growth. It has been hard for PVC, however, to document its impact.
2. **Make the cooperative development grants more competitive.** This can be accomplished in two ways. The first is to bring in new players. A second way to increase competition is to push for a greater disparity of funding levels. Currently the levels of funding are almost identical for each CDO.
3. **Choose what stage of institutional development in microfinance PVC is willing to support with its partners.** PVC has supported the start-up and expansion of some of the largest, most successful microenterprise support PVOs. It continues as well to support new entrants. PVC legitimately questions when more advanced PVOs will "graduate" and when to stop funding "more of the same". The need for a core R&D function continues indefinitely. In the new environment of scale and rapid expansion, microenterprise development organizations have to deal with ever changing issues and challenges. Some cannot raise all the core funds needed to maintain their technical assistance function. PVC should consider funding the maintenance of such capacity as a public good, require some mentoring and expect specific products for planned dissemination to the broader community. This would not only help support PVC's new partners; it would protect their prior investment old ones.
4. **PVC should meet with potential grantees and the Microenterprise Office to coordinate support.** Currently many PVOs divide up their programs and approach the two offices separately. It would be better if the two offices could coordinate the support they provide given the quality of the proposals, the level of funding available, consistency with USAID objectives and the goals of each office.
5. **PVC should not encourage new entrants in highly competitive markets.** PVC, in consultation with the Microenterprise Office and the Regional Bureaus should come up with a list of countries, in which new entrants will not be encouraged with Matching Grant funds.
6. **AID should require all new Matching Grants recipients to meet the requirements of the USAID microenterprise policy, best practice and reporting from the beginning of their grant.**
7. **USAID should have trained technicians at each Mission who will help shape and guide the development of the sector.** Part of the success of the microfinance sector in Bolivia appears to be a result of steady support over a significant period of time. The quality of microenterprise staff at the mission was key in the success of important policy and supervision changes.

PART I: TRENDS AND EVOLUTION OF MICROFINANCE & STUDY METHODOLOGY

Part I of the study gives an historical look at the field of Microfinance and the trends that are still emerging. This part of the study gives specific consideration to the role USAID has played (and is playing) in the development of Microfinance.

Part I also discusses the methodology employed in the study.

CHAPTER I: INTRODUCTION

A. THE NEW FIELD OF MICROFINANCE

Roughly a third of the population of the developing countries—well over a billion people—were living on less than a dollar a day in 1990. Moderate increases in the income cutoff level dramatically increase the percentage of poor population. Thus, at a level of \$1.50 per day, half of all people in the developing world would be considered poor. At the lower end of the spectrum, the World Bank defines “extreme poverty” as those living on less than seventy five cents a day, and notes that about two-thirds of all people who qualify as poor by the dollar a day standard are poor enough to be classified as extremely poor.

While few precise figures are available, studies typically estimate that as many as a third of poor households participate in microenterprise activities. These estimates suggest that the number of poor people depending on income from microenterprise (including family members), reaches well into the hundreds of millions worldwide (Christian, Rhyne and Vogel, and USAID Microenterprise Development Policy Paper). In many poor villages, virtually every adult is engaged in one or more agricultural or off farm income generating activities. At least half a billion traders, street food sellers, carpenters, bakers, seamstresses, mechanics, farmers and other microentrepreneurs provide most of the goods and services consumed in local communities around the world.

This “informal economy” reflects a complex ecology of trading and production based on the efficient use of scarce capital, abundant labor and available resources. It is driven by the entrepreneurial skills of the poor in a context where being productive (even marginally productive) and survival go hand in hand.

The productivity of most informal sector businesses, however, is very low. This is not due to lack of skills. It is rather due to lack of access to modest loans for tools, raw materials, inventory, seeds, or animals. An absence of developed markets in rural areas also leads to exploitatively low prices for crops and high costs for inputs. Other missing ingredients often include lack of basic business knowledge, tools appropriate for small-scale production, electricity for power tools and a safe, convenient place to save.

While locally organized and controlled savings and credit systems (such as ROSCAS) and strong traditions of mutual assistance mitigate some of the uncertainties of life for the poor, credit unions, cooperatives and PVO/NGO microenterprise programs have also been of major assistance. At their best, these programs have increased the profitability of microenterprise and farms, provided poor people with access to credit and a safe place to save and encouraged a process of societal change favoring women and the poor.

The history of these programs goes back to the 1970s when poverty alleviation became a major part of the development agenda.¹ NGOs that worked at the rural grassroots level increasingly saw poverty as the fundamental underlying problem that effected all the development issues they were attempting to address. If poor people had access to increased income, it was believed, they could invest in their own development priorities. The idea arose that poor people (and particularly women who were seen as especially poor and more likely to spend income on the needs of the family), should be assisted in “income generation”.

Large, multi-sectoral NGOs began working with crafts, sewing and weaving projects around the world. Because these institutions had no background in business themselves, little consideration was given to quality control or markets. This lack of consideration of the marketplace often led to disastrous results.

Gradually, NGOs began lending money to poor people to invest in their own business ideas, generally at subsidized rates of interest. This was consistent with their historical welfare mentality. Based on the early experience of the Grameen Bank, the idea began to spread that the poor could pay commercial rates of interest or higher and repay. The shift to “minimalist” credit was dramatic. A number of NGOs began experimenting with methodologies to slash credit costs and motivate repayments. Specific techniques were devised for group guarantees and repeat loans became dependent on prompt repayment. Once village banks, solidarity groups and individual lending emerged as efficient methodologies, emphasis was increasingly placed on the viability of financial institutions rather than on successful “programs”.

Financial institutions perform functions that are crucial for overall economic growth. They mobilize resources from savers for lending to businesses and projects, facilitate trade through payment systems, create financial instruments for clients and manage risks for individuals and firms.² Despite the proliferation of NGO projects, millions of people were still not being reached. After decades of experimentation in a multitude of credit projects, microfinance, a “new” field, emerged to respond to this problem.

Microfinance consists of supplying viable financial services to the poor. Bennett and Cuevas (1996) summarize the importance of building sustainable financial systems from three perspectives: (1) *financial sector development* to reduce the costs and risks of providing financial services to those who are not integrated into the formal financial sector because of low-income, gender, ethnic identity or remote location; (2) *enterprise formation and growth* facilitated by access to credit and deposit services; and (3) *poverty reduction* as a result of access to reliable monetized savings facilities that help the poor smooth consumption over cyclical and unexpected crisis and, once some degree of economic security is attained, access credit to improve productivity of their enterprises.

¹ This history is based on the authors’ own experience and on the Chapter “Questioning the Future of NGOs in Microfinance” by Thomas Dichter in Otero and Ryne 1996

² Ross Levine. 1994. “Does the Financial System Matter?” Unpublished paper, presented at the Inter-American Development Bank, May 1994. Washington, DC: The World Bank. May, 1994.

Microfinance, as a new field, not only resulted from project-related work done by NGOs underwritten by multilateral, bilateral and private institutions. It also developed based on examples provided by informal finance (e.g., moneylenders), and formal and semiformal financial institutions; as well as well as a solid body of academic research; (see for example) Adams et al., 1984; Von Pischke, 1991; Zeitinger, 1991; Yaron, 1992; Bouman and Hospes, 1994; Otero and Rhyne, 1994; Christen et al., 1994; Krahnen and Schmidt, 1994; Schmidt and Zeitinger, 1995; Zeitinger, 1995; and Bennett and Cuevas, 1996).

The evolution from *microenterprise finance* to *microfinance* broadened the spectrum and options for low-income men and women; acknowledging their desire for financial services to expand their choices of business and household strategies. Microenterprise finance excludes household finance (e.g. loans for housing improvement, savings) except for those that are linked to microenterprise. Microfinance, on the other hand, includes the savings of the poor and a wide range of financial services for a range of individuals. This new direction has several dimensions:

- ***From a limited number of target beneficiaries to broad outreach:*** While microenterprise credit projects target specific types of beneficiaries, new approaches based on institutional viability increase market segmentation and expand the range of microenterprise served, thus expanding the potential to reach large numbers of poor people.
- ***From short-term project objectives to long-term institutional viability:*** Rather than working towards financial sustainability, microenterprise NGOs and other formal and semiformal financial intermediaries focused on accomplishing short-term project objectives determined by funding agencies. ‘Microenterprise credit projects’ became dependant on external funds. The new view focuses on developing and/or strengthening permanent institutional capability in order to become independent of donor subsidies and to tap local and international capital markets and savings.
- ***From isolated NGO credit projects to becoming part of the formal financial system:*** The new view on microfinance has resulted from successful experiences such as those of NGOs that have created or become regulated financial institutions (e.g., Prodem and BancoSol, Bolivia; AMPES and Financiera Calpia, El Salvador). The practical experience of creating and delivering new financial instruments that reach poor people has raised a new wave of debates around how MFIs fit into the financial system, and about their regulation and supervision. MFIs and regulatory authorities are learning about the possibilities for offering financial services to the entire economically active population.³ Microfinance provides a broader perspective for reforming financial regulation to create a level playing field where the majority of people (the poor) can gain access to services.

³ See: Craig Churchill, ed. (1997). Regulation and Supervision of Microfinance Institutions. Washington, DC: Microfinance Network; Carlos Cuevas. 1996. “Enabling Environment and Microfinance Institutions: Lessons from Latin America.” in Journal of International Development. Vol. 8, No.2, p. 195-209; Rodrigo Chavez and Claudio González-Vega. 1994. “Principles of Regulation and Prudential Supervision and Their Relevance for Microenterprise Finance,” Otero and Rhyne, eds. (Ibid). p. 55-76.

1. The CDO role in Microfinance

The development of microfinance in the cooperative and credit union sectors paralleled that of the PVOs/NGOs. In the 1960's, the financial sector was comprised primarily of the formal banking sector and informal finance such as loan sharks and ROSCAs. Banks neither accepted savings from small account low-income groups, nor made small or rural loans. Credit unions offered the only semi-formal alternative. Therefore, donor funds for credit unions were plentiful, and credit unions were good at accessing them. Missionaries and Peace Corps volunteers started numerous credit unions, which had a strong social welfare purpose—assisting the poor.

According to Jeff Poyo (1987), these credit unions generally lacked professional management, were weak at loan recovery and earning profits for future expansion and usually kept loan interest rates very low to benefit borrowing members. Low lending rates meant that deposit rates were also generally kept low. With substantial grant and soft loan funds available through external donors, many credit unions continued to grow rapidly, despite the lack of deposit mobilization, loan recovery and retained earnings.

During this period WOCCU was pushed by donors to focus on a “trickle down” strategy with an emphasis on formation and subsidization of national credit union federations to “efficiently” spread a simple uniform methodology. However, the proliferation of many small credit unions with a negative return to savings, cheap loans and high delinquency led to stagnation by the 1980s. Credit union penetration remained at less than 1% in Asia, and besides the Caribbean, remained low elsewhere as well (with individual country exceptions). This led to the emergence of alternative NGO financial institutions to fill the credit union niche. The credit unions, in effect, created their own competition.⁴

WOCCU realized that the overall credit union track record required a re-thinking of credit methodology, damage control, and competition with the new providers of microfinance (Village Banks, Solidarity Groups, and Commercial Banks) going down market.

The subsequent changes in institutional and technical assistance models opened the door for credit unions to be fully recognized as successful microfinance providers. The new credit union model fit neatly into the conceptual framework of microenterprise in that it emphasized financial sustainability, a variety of products, local participation and a balance between the interests of savers and borrowers.⁵

Other CDOs have developed technologies for rural finance that maintain a commercial outlook, lending to off-farm enterprise to diversify risk, in-depth assessment based on cash flow, pricing based on costs and risks, longer term loans and close supervision. This approach has been implemented in transforming several banks and up-grading program into successful institutions. Given that one of the major issues of microfinance is finding ways for institutions to reach more rural populations, the CDOs have a lot to contribute.

⁴ This analysis comes directly from WOCCU's Strategic Planning efforts.

⁵ Further details of the transformation of the WOCCU Technical Assistance approach and of the financial strengthening of credit unions appears throughout out this document

2. Competition

As cooperatives, credit unions, NGOs and regulated non-bank financial institutions try to increase outreach and banks move “down-market”, competition has become a frontier issue.⁶ The challenges around competition are numerous. They include:

- **The possibility of shakeout among microfinance providers.** In Bolivia, there is discussion of mergers and acquisitions between FFPs, banks and NGOs depending on the evolution of the competition. Others feel that many current microfinance providers may simply be forced to close their doors.
- **The drive to become a regulated financial institution.** In Bolivia and elsewhere, an institution has to come under the regulation of the Superintendency of Banks or a similar regulatory agency to capture savings. In highly competitive markets, the pressure to become regulated is strong, even among rural village banks programs. NGOs such as the ACCION affiliate PRODEM have evolved into microenterprise banks, and numerous others have become regulated MFIs.
- **Dealing with impact of consumer credit.** In some countries, banks and consumer finance organizations are giving consumer loans to salaried employees. With extremely high interest rates this is a lucrative product even with high delinquency rates. Agents are thus being pushed to get more credit out the door. This has led to the extension of consumer credit to microentrepreneurs. This has led, in turn, to distortions in the market.
- **The drive to reach poorer, more rural populations.** As many urban markets get saturated, institutions feel pressure to expand to previously under-served areas. Aside from any social agenda, they see this as a source of new clients who are willing to pay comparatively high interest rates.
- **Dealing with the growing problem of over-indebtedness.** With loans available from a wide variety of sources many microentrepreneurs are taking multiple loans and “bicycling” (using new loans to pay off older ones). In some countries, regulated microfinance institutions are starting to share information on their borrowers.
- **Client knowledge of credit availability and terms.** A positive aspect of competition is that it generates options for borrowers. Many microentrepreneurs interviewed during the fieldwork could mention at least three or four institutions, their interest rates, terms, processing time etc.
- **The wholesale borrowing of methodologies.** With intense competition and well-documented best practices (funded by donors, established by PVOs/CDOs, researched by academics and disseminated by practitioner networks, such as the MFN and SEEP, and direct observation in the marketplace) institutions borrow methodology from each other freely.

⁶ See the soon to be published paper: Christen, Robert Peck and Rhyne, Elisabeth. Microfinance Enters the Marketplace.

3. Methodology Diffusion

There are numerous examples of methodology diffusion. One involves village banks. FINCA originally established village banks as pre-cooperatives or “quasi-credit unions” to serve the credit needs of poor women it felt credit unions were no longer reaching. The village banking model spread to a variety of PVOs including a number of large, multi-sectoral PVOs like CARE and Catholic Relief Services for which it served as an entrance to the sector.

The methodology was transformed by Freedom from Hunger into Credit with Education. Credit with Education added small, marginal costs onto the village banking methodology to try to educate women on health and family planning issues and impact the end use of income. Many PVOs that previously had focused only on Child Survival, such as Helen Keller and Project Hope, have borrowed Credit with Education. FINCA, in turn, has started urban village banks and will begin to experiment with individual loans to their most successful clients rather than graduating them.

Freedom from Hunger realized that it needed a sustainable second-tier home for its successful village banks or credit associations. It found one in the credit unions. In Burkina Faso, 49 credit unions are carrying out the Credit with Education approach. Credit with Education has grown to serve 30,000 mostly illiterate women organized into 1,230 village banks located as far as 35 kilometers from a local credit union office. The credit unions, including the associated village banks, are profitable and use member savings for loans. WOCCU and Freedom from Hunger are now working together to spread this model further.

Credit unions in their efforts to compete in providing products to microentrepreneurs have borrowed methodology from both the commercial banks and solidarity groups. In Ecuador, a WOCCU project has developed 11 products targeted to microentrepreneurs that are now being piloted by individual credit unions. These products came from a close examination of the formal banking sector.

In Bolivia, the largest credit union, Jesus Nazareno, has successfully reached urban market vendors through solidarity groups by hiring away Banco Sol staff fully versed in the solidarity group methodology. Jesus Nazareno has disseminated the solidarity group methodology to 10 other credit unions through a WOCCU sponsored workshop. Solidarity groups have served credit unions as a sort of cross co-signer mechanism. In turn, Banco Sol and other institutions providing solidarity group credit have started to provide individual loans themselves after seeing their best solidarity group clients graduate to individual credit at other institutions.

Instead of a separate evolution of credit union, PVO/NGO and banking approaches over the years, an active process of hybridization is underway, with methodologies disseminated across “camps” through a conscious process of dissemination, or by stealth, when a competitor hires away the trained staff of another institution. Credit unions and other MFIs are getting more similar. The extent to which and how this has transpired is one of the central themes of this study.

B. BUSINESS DEVELOPMENT SERVICES

Despite the impact of microfinance, liquidity is only one problem facing small producers. Credit on its own often tends to generate an expansion of existing activities, rather than stimulating increased productivity, value-added innovation in the form of product development and reaching out to new markets or sustainable growth. For many active microentrepreneurs, inadequate business management and marketing skills and limited knowledge of improved production techniques and market opportunities pose more serious barriers to growth than lack of credit.⁷

Business development services (or non-financial services as they were previously called) can often leverage real change and growth. The experience of USAID and other donors in supporting business development services stretches over several decades. One main contribution of USAID was its support, under the GEMINI project, for development of the subsector approach. With the subsector approach, the analysis and diagnosis of small producer constraints differs from conventional approaches in that the focus of intervention is not the individual small producer, but on the system or subsector in which he operates (Malhotra and Santer, 1994, Boomgard et al., 1992).

Subsector analysis studies the vertical structure of a given economic activity (e.g. blacksmithing, silk production, or dry-season vegetable production) from early input supply through production process and marketing of the final product. This permits identification of 1) bottlenecks constraining the economic activity, 2) niches in which small producers have a comparative advantage, and 3) specific interventions that can ease the bottlenecks and facilitate the exploitation of niche opportunities.

Project level interventions then can be addressed towards system nodes (key points in the production and marketing chain) where many products or services pass through relatively few hands. Several PVOs (especially CARE and Save the Children) used subsector analysis quite frequently. Since subsector analysis emerged from its predecessor, agriculture sector analysis, this PVO work is quite similar to the analysis carried on by their agriculture- based CDO counterparts for years.

Since cooperatives are private sector businesses formed to provide tangible economic benefits to their members, many of them are involved in technical assistance, input supply, marketing and other business development services. Particularly in Africa, US-based PVOs such as TechnoServe, Volunteers in Technical Assistance, Appropriate Technology International, CARE World Education and Africare are involved in business development services as well.

⁷ For an excellent discussion of the limitations of a credit-led approach see Dawson, Jonathan. "Beyond Credit: The Emergence of High-Impact, Cost –Effective Business Development Services" in Small Enterprise Development Vol.8, Number 3

C. USAID CONTRIBUTION TO MICROENTERPRISE DEVELOPMENT

USAID's formal involvement in microenterprise began with the PISCES Project in 1978. The purpose of PISCES was to synthesize lessons learned in the then newly emerging field. Towards that end, the project investigators⁸ were given an open challenge to learn about how informal sector businesses could best be assisted. While most of the institutions studied could be characterized as low performing, with high costs and low repayment, a few performed remarkably well. Their common characteristics became the basis of the first iteration of "best practices". USAID continued its support for the Research and Development efforts of academics and practitioners through the ARIES and GEMINI Projects.

The current USAID Research and Development projects are Microenterprise Best Practices Assessing the Impact of Microenterprise Support (AIMS), and MicroServe. Microenterprise Best Practices' capacity-building and innovation grant programs support the efforts of microenterprise organizations and networks to promote industry-wide best practices, and encourage innovation in microfinance and business development services. Microenterprise Best Practices is a responsive funding program, thus its portfolio of grants represents diverse activities and issues identified by practitioners. To date it has awarded 16 grants for almost a million dollars. MicroServe offers technical assistance to USAID field missions and implementing organizations, while AIMS develops tools to measure household impact and welfare improvements for microentrepreneurs and communities.

Another area in which USAID support has had profound impact is in the area of institutional capacity building. For decades, donors have invested a growing percentage of their development resources into building the capacity of institutions dedicated to supporting income generating activities and businesses in the informal sector. USAID has been a leader in this area, spending large sums of money, over many years, building the technical capacity of US-based PVOs⁹ and CDOs involved in microenterprise development. One key element of this capacity-building approach has been a limited number of Matching and Cooperative Development Grants issued on a competitive basis each year. The intent of these grants is to allow PVOs and CDOs to:

- Achieve sustainable service delivery (through changes in policies, values, structures, staffing, and business management skills);
- Diversify their funding base;

⁸ The contractors included ACCION International as the Prime contractor, Partnership for Productivity and the Development Group for Alternative Policies. Accion and Partnership for Productivity had been involved in microfinance since the early 1970's.

⁹ The USAID definition of a PVO is a tax-exempt, non-profit organization working in, or intending to become engaged in, overseas development activities that receives some portion of annual revenue from the private sector and receives voluntary contributions of money, staff, time or in-kind support from the general public. Among them are organizations working with cooperatives known as "cooperative development organizations" (CDOs), organizations specializing in microenterprise development in a number of program areas (training, credit, Technical Assistance etc.) and others specializing exclusively on microenterprise credit. For the purpose of this study we will refer to the cooperative-related PVOs as (CDOs) and to the others as PVOs.

- Increase their ability to strengthen indigenous institutional partners; and
- Improve their capacity to measure impact.

The USAID Office of Microenterprise Development now funds those “graduates” of the BHR/PVC grants which can demonstrate evolution towards institutional viability based on their performance (as measured by the scale and depth of their outreach and the financial sustainability of their services and programs). USAID has also supported its PVO/CDO partners by funding the SEEP lateral learning network. SEEP is an association of 42 North American private development organizations that support micro- and small enterprise programs in the developing world. SEEP’s mission is to promote professional standards of practice, conduct an educational program for its members and other practitioners, create and disseminate publications with high field applicability and serve as a center for collaboration on a broad range of sector related issues.

The existence of the Office of Microenterprise Development is, itself, an indication of USAID’s contribution to the field. In June 1994, the agency launched the Microenterprise Initiative, a set of policies, strategies and actions designed to make microenterprise a major part of USAID’s economic growth strategy. The Office of Microenterprise Development was created to be the main hub of technical resources and the management unit for the central funding mechanisms. The office’s goals are expected to have impact at three levels:

- At the level of poor people, helping them to increase their income and assets, thereby gaining the basis to improve their welfare;
- At the level of the local economy, increasing its skill and productivity, so that its capacity to grow is enhanced; and
- At the level of local organizations, facilitating their capacity to serve the microenterprise sector.

The aims of the Microenterprise Office are detailed in USAID’s Microenterprise Policy Paper. They include: 1) maintaining focus on women and the very poor, particularly through support for poverty lending; 2) helping implementing organizations reach greater numbers of people; 3) supporting institutional sustainability and financial self-sufficiency among implementing organizations; and 4) seeking improved partnerships with local organizations in the pursuit of microenterprise development. The Policy Paper has provided consistency within the agency in terms of the types of institutions supported, the type of support to be provided, the policy dialogue to be engaged in, the definition of what constitutes microenterprise etc. This has provided guidance not only for USAID, but also for other international donors and practitioners.

USAID also involves itself in policy dialogue in an effort to ensure an efficient and competitive financial system that will work to the benefit of microentrepreneurs and other under-served segments of society. Aside from the removal of interest rate ceilings, one area of successful policy impact has been on supervision and prudential regulation of financial institutions.

D. THE PURPOSE, DESIGN AND METHODOLOGY OF THE STUDY

1. Purpose

The following excerpt from the Scope of Work summarizes the purpose of the study:

“The experiences and lessons learned by the different Cooperative, Credit Union and PVO programs need to be summarized and shared within PVC, among grantees, and with other Bureaus to help guide future micro-finance activities. The study will foster greater collaboration and synergy between PVOs, Cooperatives and Credit Unions. A key impetus of this study is an expressed desire by the cooperative lending community to better articulate their experience in this area and how it relates to the micro-enterprise initiative. The study will be focused on the best practices and lessons learned from USAID grantees’ implementation of micro-financing activities, over the last ten years, in both rural and urban areas in third world countries.

BHR/PVC will use the study results to more effectively utilize its resources to strengthen micro-financing organizations and the non-financial resources they provide. The findings and recommendations of the study will also contribute to strengthening micro-finance assistance throughout USAID.”

2. Study Design

The study focuses on the following areas:

- a. *An examination of how USAID has built the internal capacity of PVOs and CDOs, and how this, in turn, has built sustainable local institutions with strong outreach***- The idea is to look at a USAID funds invested in the capacity of a CDO or PVO and what it leads to in terms of outreach, performance and sustainability in local institutions.
- b. *Cooperatives and Credit Unions***- The study is based on an examination of best practices. The promotion of PVOs/NGOs specializing in microfinance has been based on the sharing of best practices from a group of successful cases. By contrast, “bad practices” dominate much of the literature on cooperatives. This is a result of projects back in the 1960’s and 1970’s in which donors pumped money into coops and credit unions, using them as conduits to channel highly subsidized resources into the agricultural sector. There are many individual cooperatives and credit unions, which currently have superb scale and depth of outreach and are sustainable. Given the relative dearth of best practice materials on the coop sector, two-thirds of the study’s resources will be devoted to documenting this experience.
- c. *Individual Credit Unions and Cooperatives as well as “Systems”***- Studies of credit unions have often looked at aggregated statistics. While “Leagues” or “Federations” may or may not be strong nationally, there may be a smaller number of credit unions that are having substantial impact at the community level. We must study those individual institutions to

determine which factors make some credit unions perform well according to the new microfinance criteria of outreach and sustainability.

- d. ***Learning Between Institutions***- There is a significant amount of learning that must continue to happen. Although credit unions, cooperatives and PVOs with microfinance programs share a common mission, and the populations they serve and the services they provide often overlap, there has been little systematic exchange of learning between the two communities. The study will look at how learning has taken place within OCDC and SEEP and what interesting hybrid programs have emerged between CDOs and PVOs. This will include efforts of one institution to “piggyback” its interventions onto another and the dissemination of different methodologies based on competitive pressures in the marketplace.
- e. ***A Look at the Microfinance “Sector” in a Number of Countries***- The team chose to travel to some countries in which there are thriving, highly competitive microfinance sectors. The idea was to look at credit unions’ and cooperatives’ levels of participation as suppliers of financial services in these markets. What are their contributions as financial intermediaries? What types of clients do they reach and what is the nature of their market niche? Besides the countries we visited, we tried to use part of the literature review to examine credit unions and co-ops as players in a larger market.
- f. ***A Strong Emphasis on Microfinance***- Many CDOs focus on business development services and the provision of infrastructure rather than microfinance. As a result, the study must consider Business Development Services as well as financial services. The literature, however, is heavily weighted towards microfinance, since that sector has proven able to provide services to large numbers of genuinely poor people, at relatively low cost and a high level of sustainability. In addition, most of the institutions we observed and spoke to on our trip were focused on microfinance. Given the way the Scope of Work was written and the realistic constraints faced by the team, a decision was taken to focus on microfinance.

3. Methodology

The methodology consisted of undertaking the following specific activities:

- a. ***Headquarters interviews with PVOs/CDOs***- To ensure a broad look at a variety of institutions, a typology of institutions was set up. Interviews were carried out with US-based CDOs, non-US CDOs, PVOs doing cooperative development, large-scale multi-sectoral PVOs, and relatively small PVOs focused exclusively on microfinance. Each type of institution was seen as having its own unique set of issues. (A complete list of key interviews is included as an appendix to this document)
- b. ***Interviews with donors and academics.***
- c. ***Field Study***- The team initially focused on two countries: Bolivia and Ecuador. These countries had several advantages: 1) a very rich array of programs and institutions leading to

competition within the sector, 2) lots of USAID microfinance funds, 3) good data on impact and 4) an abundant literature on “best practices” in the various microfinance institutions.

While Bolivia and Ecuador are particularly rich cases, there would also be disadvantages to focusing on these two countries. The first is the obvious lack of geographic diversity. What works in Latin America may not be relevant in rural Africa, for example. The second is the fact that neither contains the Freedom from Hunger/ credit union hybrid, which represents a breakthrough technology among joint efforts on the part of PVOs and CDOs.

The team ultimately decided, therefore to add a third country, Burkina Faso. Burkina is as different in context as a country can be from Latin America and it contains the first and best of the village bank/ credit union hybrid model. Other countries representative of these models were either impossible to visit for one reason or another (Mali, Niger) or impractical (Philippines). The team firmly believed that a first hand view of this hybrid in Burkina Faso was key to identifying an important CDO/PVO best practice.

We used the visits to the three countries as case studies of credit unions, coops and other MFIs, to analyze how they are providing financial services to microentrepreneurs in a given country. The idea was to compare the credit unions and cooperatives to other MFIs that are providing similar services to microentrepreneurs within a similar set of economic, political, social and cultural factors.

The key areas for comparison of performance are based on the agreed upon indicators of best practice: outreach (providing large numbers of poor people including the very poor and women) access to quality financial services), and financial sustainability (becoming independent of continued inputs from governments, international donors or charitable organizations.) Comparisons also enabled us to focus on factors that make markets more competitive and efficient.

d. *Literature Review*- With limited field time available, the literature review became increasingly important to the team’s ability to complete its task. Given the study’s focus on cooperatives, the team spent at least two hours with each of the CDOs discussing what documents were available. The Research Assistant then spent considerable time retrieving: 1) documents on the specific countries the team would be visiting, 2) Matching and Cooperative Development grant evaluations of the key PVO microenterprise players and 3) publications on the latest cutting edge issues in microfinance. The Research Assistant also gathered data to prepare tables on what resources each PVO/NGO had received to increase its capacity in microenterprise development, and to make marketplace comparisons. Comparisons in some cases proved difficult, as many cooperative development grants did not have a microenterprise development focus.

CHAPTER II: BUILDING CDO AND PVO INSTITUTIONAL CAPACITY IN THE US TO SUPPORT MICROENTERPRISE DEVELOPMENT IN OTHER COUNTRIES

A. THE ROLE OF USAID/BHR/PVC IN STRENGTHENING THE GRANTEES

USAID has played a critical role, beginning in the late 1970s, in strengthening the capacity of the members of the US private voluntary community to plan, implement and evaluate development programs. The depth and magnitude of the USAID- PVO/CDO partnership around microenterprise development has continued to increase.

Coupled with the USAID- PVO/CDO partnership has been a significant increase in the potential of the non-governmental sector abroad: indigenous NGOs and community-based organizations (CBOs). While the role and size of the indigenous NGO sector varies widely between regions, and on a country by country basis, USAID has increasingly turned its attention to building the capacities of such indigenous organizations as a prerequisite to broad-based sustainable development.

The growing number and importance of local NGOs has had significant implications for the role of US PVOs and for the USAID- PVO partnership. Today, USAID looks to US PVOs less for direct service delivery and more as partners in, and facilitators of NGO-implemented activities. This has brought the importance of local institutional capacity building to the forefront, as a matter of both USAID policy and practice. This is evidenced by the agency's New Partnerships Initiative and in the way the Office of Private and Voluntary Cooperation (PVC) supports its mission through the grant programs it administers.¹⁰ US CDOs, on the other hand, have always focused on partnership as opposed to direct service delivery.

1. Matching Grants

The Matching Grant Program assists PVOs that address development priorities that are consistent with those of USAID. Microenterprise has gradually become a focus sector. Matching Grants provide core support for internal capacity building for PVOs and, through them, to their NGO partners to professionalize their management systems, or technical backstopping of programs. Other grant purposes include: replication of proven program approaches in new places, expansion to new sectors or the undertaking of innovative projects which offer opportunities for transferring new skills and methods. These grants, which are matched by PVOs on a dollar for dollar basis, leverage private resources for development and help to strengthen the viability of the PVO recipient. The funding level for the most recent fiscal year was just over \$18 million and 14 of 35 proposals were funded.

¹⁰ Holloway, Richard et al. Strengthening Southern NGOs: The Donor Perspective Vol. 2. USAID May 1998

PVC sees itself as a key partner with the PVOs with whom it works. Indeed, this view is shared by PVOs as well. Many PVOs credit the PVC office with being the single Office at USAID with an understanding of, and ability to enhance, the important role which U.S. based PVOs play in microfinance. PVC demands strong links between the PVO Headquarters and its field programs, an active Board of Directors committed to excellence in the sector, market rates of interest, solid technical staff and active membership in SEEP. Rejected applicants often spend a year under the informal tutelage of PVC reformulating their ideas. Many of the PVOs interviewed stressed the importance of the Matching Grant application process itself in forcing a level of disciplined thinking and strategic planning which might have been otherwise lacking at the broadest organizational level.

USAID currently gives grants at three separate stages of the institutional development process: learning microenterprise, going to scale and institutional transformation. There was disagreement among those interviewed for this study as to which of these stages should be PVC's emphasis. Most argued that in many countries, the microfinance market is already saturated, with a future shakeout among existing players possible. New start-up institutions were seen as having the potential to distort the market by lowering interest rates and raising delinquency. At a minimum, these people suggest that there be a list of countries in which there are well developed MFIs, and that in such countries, further entrants not be encouraged with grant funds.

With less funds going to bringing new players into the field, the implication is that additional funds would be available to fund the continued research and development efforts of highly successful institutions which have previously been strengthened with grant funds. Some of these institutions still lack the core funds to support their key Headquarters personnel to insure the further improvement and dissemination of their models. The need for a core Research and Development function in microfinance PVOs continues whatever their level of success. In the new environment of scale and rapid expansion, microenterprise development organizations have to deal with ever changing issues and challenges.

The issue is whether PVC should "graduate" such institutions to free up funds for new PVOs to "learn" microenterprise. Those who answer in the affirmative point to "Child Survival" PVOs adopting "credit with education" as an important new frontier. They also recall a time when "ACCION was a multi-sectoral, non-governmental Peace Corps with no microfinance expertise at all". PVC is faced with an important strategic decision as to how to allocate its grant funds among the three stages of development.

A quick examination of Matching Grant evaluations shows a vast array of training events, computerized financial and accounting systems, publications and technical support units purchased with grant funds. As Philip Boyle points out in his evaluation of PVC's microenterprise grant assistance, however,

"In some evaluations little attention is given to the specific role of the Matching Grant within the overall evolution of the PVO and its affiliates; in others, there is insufficient focus on field programs."

The test of a PVO's capacity lies in the quality, scope, cost and sustainability of the services it delivers to poor people. If US PVOs continue their present evolution to intermediary organizations between donors and local NGOs, their ability to build local NGO capacity will be reflected in their clients' service delivery."¹¹ There do exist several evaluations which look at local partners' progress on operational variables such as number of active clients, total number of loans disbursed, the range and average size of loans, repayment rates, percentage of clients who are female etc. The conclusion is that the impact of the Matching Grant program has been substantial. Profiles of several institutions supported by these grants follows in Section C-I of this chapter.

2. Cooperative Development Grants

The Humphrey Amendment to the Foreign Assistance Act of 1961 (along with other legislation) has allowed USAID to dedicate substantial support and financial assistance to US CDOs to carry out development overseas. PVC administers a competitive grants program for cooperative development. The Program uses the expertise and resources of a short list of long-established CDOs, their members and volunteers to respond to the needs of cooperatives and other group-based businesses overseas. The current five-year grants run from 1997 to 2001 for a total of \$6 million annually.

The 1996 evaluation of the overall program¹² found that Cooperative Development Grants have had a very beneficial impact on the growth of cooperatives overseas and the economic growth of host countries. The evaluation also showed the program had significantly leveraged additional USAID funds for the development of cooperatives and credit unions. However, most of the CDOs were still dependent on direct USAID financial support and grants for the majority of their development funds. Five of the seven CDOs who had participated in the project and its predecessors for 15 years or more still received over 90% of their development funds from USAID. The other two received 70-80% of development funds from USAID. That led to recent changes in the grant mechanism that included requiring a 15% cash or in-kind match with limited use of grant funds for leveraging additional USAID funding.

With a stable number of responses to the Request for Applications, a stable number of grantees over a period of years, as well as a fairly even distribution of funds between recipients, there was concern that the "core" funding had not fostered management efficiency. This led to the recent changes to target-specific programs in fixed countries. In efforts to introduce new cooperatives to international development work, PVC encouraged sub-grants with new CDOs. ACDI/VOCA currently has a sub-grant with Southern States, Land O'Lakes has a sub-grant with Minnesota Health Partners and NRECA has a sub-grant with the National Rural Utilities Cooperative Finance Corporation.

There are clear differences between the CDOs supported by the grant. One key area of difference is the sector supported. WOCCU is the primary financial sector CDO. ACDI/VOCA and CHF

¹¹ See Boyle, Philip. USAID/PVC Microenterprise Portfolio Assistance, P.2

¹² Mid-Term Evaluation of the Cooperative Development Program of BHR/PVC USAID, August, 1996

provide significant financial services, and NCBA and Land O'Lakes leverage other financial resources. ADI/VOCA, Land O'Lakes and NCBA operate mainly in the rural agriculture sector; CHF is focused on the housing sector; AAC/MIS supports insurance; while the other two CDOs NRECA and NTCA concentrate on infrastructure. This sectoral breakdown means that the activities of some CDOs will be more relevant to microenterprise development (and the study's specific focus on microfinance) than others. Each CDO and its relevance to microenterprise will be discussed in section C.2 of this chapter.

B. A LOOK AT THE OUTCOMES RESULTING FROM USAID SUPPORT

1. Private Voluntary Organizations

The team looked at a sampling of eight PVOs in this study to assess:

- The evolution of the field of microfinance in the past ten years, accepting the experiences of these eight institutions as representative of the field in general;
- PVC's impact on the field of microfinance in the past ten years from the perspective of scope and depth of outreach at the field level, using a somewhat simplistic dollar in/dollar out approach, as well as from the perspective of internal capacity building as discussed in interviews with each of the organizations;
- The issues, constraints, and challenges the field and these individual institutions currently face, as well as the current strategic thinking for addressing these challenges; and finally,
- Frontier issues with suggestions for the PVC office going forward.

The eight PVOs were chosen for their prominence in the field of microfinance, their diversity of approach to microfinance, as well as for the consistent support they have received historically from the BHR/PVC Matching Grant Program. The eight PVOs included in the study are:

ACCION International: ACCION is currently receiving a five-year Matching Grant which runs through August 1999. ACCION was one of the early recipients of Matching Grant support. The goal of ACCION is to transform its affiliate organizations into self-sustaining financial institutions, capable of providing services to an ever-growing number of the hemisphere's poor. ACCION considers its affiliates as self-sustaining when they can: a) cover their operating and financial costs from income generated by their activities; b) capture funds from commercial financial markets or through savings vehicles; and c) achieve independence from donated funds in the long-term.

CARE: Received its first Matching Grant in 1987, extended it for a year in 1993 and was awarded a second in 1996. Small enterprise development was a component of their initial program. CARE was founded in 1945 and currently operates in 38 countries throughout the world. CARE works across the entire spectrum of relief, rehabilitation and development activities. The organization incorporated small enterprise development into its poverty alleviation strategies in 1986 with PVC support. CARE integrates its microfinance programs into its *Household Livelihood Security* framework defined as "adequate and sustainable access to income and other resources to enable households to meet basic needs," (including adequate

access to food, potable water, health facilities, educational opportunities, housing, time for community participation and social integration.) Currently, CARE has microenterprise activities in more than 20 countries, working with 63 MFIs to reach almost 15 million clients.

Catholic Relief Services: CRS received its first Matching Grant for small enterprise development in 1988, a second in 1993 and will be receiving a third in 1999 after a one year hiatus. Like CARE, CRS is a multi-sectoral relief and development organization. CRS began working with local partners to implement credit and savings programs focused on women in the early 1960s. However, it was not until 1988 with support from its first Matching Grant that CRS created its *Small Enterprise Development Technical Unit*. Using a village banking methodology, CRS is committed to serving the poorest in the community, specifically targeting women. Currently, CRS is working with more than 50 MFIs to reach more than 70,000 clients.

FINCA: FINCA has received two Matching Grants from the PVC office. FINCA has received Matching Grant support from 1992-1999. FINCA is an agency solely committed to the work of microfinance. Its founder, John Hatch, was the originator of the village banking methodology, now considered one of the standard microfinance methodologies. Currently, FINCA has microenterprise activities working with more than 70,000 clients.

Freedom from Hunger: FFH received its first Matching Grant from the PVC office in 1988, a second in 1993 and will be receiving a third in 1999. Founded in 1946, the goal of the agency has always been to enable the poor to help themselves eliminate the immediate causes of chronic hunger and malnutrition. In 1989-90 FFH began their successful Credit with Education program which continues to be their primary approach to microfinance.

Opportunity International: OI has received four Matching Grants, the first in 1979, the second in 1988, the third in 1993 and the most recent in 1998. Founded in 1971, OI is a worldwide development organization that focuses exclusively on creating employment and income opportunities for the poor through small and microenterprise development. They are not limited to one methodology or target group, working instead with individual lending and trust banks, which is a hybrid of the village banking, community development and the Grameen bank model. Trust banks target poor women who form solidarity groups with 25 to 35 members, and individual lending is aimed at larger businesses, with 5 to 10 employees who need capital to expand. Currently, OI has microenterprise activities working with 51 MFIs to reach more than 42,000 clients.

TechnoServe: TechnoServe has been receiving Matching Grant funding since 1979. The organization was founded in 1968 and its goal is to improve the economic and social well being of low income people in developing countries by creating and supporting the growth of small to medium scale rural enterprises. Traditionally, they have done this through a community-based enterprise strategy, providing technical assistance to cooperatives at the grass roots level. With financial support from the PVC office, TechnoServe has recently undergone an organizational restructuring and refocusing that will broaden their approach to include working with entrepreneurs, and collaborations with non-community based commercial entities. The only

PVO included in the study that does not give credit, TechnoServe was of interest to the team because of their specialized work with cooperatives.

World Relief Corporation: WRC has received Matching Grant funding for small enterprise development since 1988. Founded in 1944 as the international relief, development and refugee service arm of the National Association of Evangelicals, WRC currently supports programs in 20 countries and administers a refugee resettlement program in the U.S. The goal of the organization is to improve the welfare of children by strengthening their families through community development. WRC integrated microenterprise development programs into their community development strategy in the mid-1980s. More recently, WRC began using microenterprise development as a tool to assist families to recover following complex disasters, thus shortening the period during which traditional relief is necessary. Currently, WRC is working with 4 MFIs to reach 36,000 clients.

An assumption of this study is that a dollar of USAID core support builds internal capacity on the part of PVOs and CDOs that, in turn, builds local institutional capacity. In terms of impact, the data show that PVC support had little field impact initially. However, this investment in organizational capacity began to pay off by 1992 as the numbers served at the field level began to increase almost exponentially. This “lag time” validates the PVC office’s commitment to capacity building, even though the benefits are not immediately quantifiable.

In terms of outreach, the data shows that Freedom From Hunger has the greatest depth of outreach with the lowest average loan sizes of the matching grant recipients reviewed. It also has a wholly female client population. Their dramatic increase in clients from 1995 and onward points to a shift in methodology and the initiation of the hybrid credit union/Credit with Education methodology. World Relief Corporation has the smallest program due to the challenging nature of their market niche, working in countries beginning the recovery process after natural disaster or war. World Relief Corporation often starts programs from scratch in the absence many times of even the rudiments of a financial infrastructure. Catholic Relief Services is a compelling case for PVC commitment to a program which grew as a result of Matching Grant support from 94 clients in 1988 to close to 68,000 clients in 1998. FINCA has grown from 19,000 clients to 93,000 in the past seven years while ACCION has remained the institution with the largest beneficiary population in our sampling.

What follows are illustrative outcomes from the Agency’s 1997 Results Reporting which gives an idea of the institutional impact of USAID support for its total portfolio:

- A record 1.4 million clients had active loans from USAID-supported institutions, up 47% from the end of 1996.
- These loans were valued at \$645 million, an increase of 113% from 1996. 67% of active loans were poverty loans
- There were 2.1 million clients participating in savings programs of USAID-supported institutions. These clients had \$372.8 million in savings.

- There was \$165.1 million dollars of support for microenterprise development. Since 1994 when USAID first announced the Microenterprise Initiative, funding has slowly increased despite cutbacks in overall agency budgets.
- The average annual growth in the number of clients served by USAID-supported financial institutions has been 150%.
- 481 institutions received USAID funding and 26% of these had accomplished full financial sustainability. Of these partners US PVOs comprised 22%, local NGOs 48%, and credit union organizations 14%.

2. Cooperative Development Organizations

Each CDO has its own unique history, issues and challenges. What follows in this section is a brief description of each of the PVC supported CDOs with specific attention paid to their relevance to microfinance. A more complete discussion of each of these institutions has been put into an appendix to keep the length of the body of this document manageable.

WOCCU : One of WOCCU's main contributions to the field of microfinance is that it has a successful savings and credit model. As Carlos Cuevas¹³ points out: "Credit unions are a self-sustainable means of reaching the poor. Their apparent neglect in the literature and in the various events associated with provision of financial services to low income households and micro and small enterprises disguise the real significance of credit unions in these markets. The challenges credit unions face today in Latin America are likely to force the sector to further modernize, consolidate, fine tune their inherent advantages and improve mechanisms for prudential regulation and supervision, while maintaining or enhancing their relevance in low and middle-income market niches." WOCCU also has a well-defined technical assistance package for financial strengthening of credit unions, addition of products targeted at micros and improved supervision.

Not only have credit unions been found to be second only to banks in lending and especially supplying deposit services to low-income clients (World Bank 1996), but their prevalence stems from real advantages they have over other providers of financial services to marginalized clients. These include: 1) the diversity of their clients base; 2) information advantage due their community foundations; 3) a general ability to supply, simple, accessible deposit services; and 4) a capacity to lend to self-employed clients while obtaining adequate repayment performance.

Aside from strengthening credit unions, WOCCU has two things to contribute to the broader microfinance community: lessons learned on savings mobilization and credit unions as a possible institutional home for village banks programs. WOCCU is experimenting with Freedom from Hunger in the Philippines in tying village banks to individual credit unions. Assuming the success of this program (and the approach has been quite successful elsewhere), WOCCU will have the capacity to replicate it on a broad scale. This has the potential to solve one of the most daunting problems facing village-banking programs around the world, that of finding a sustainable, second-tier home.

¹³ Cuevas, Carlos. Credit Unions in Latin America: Recent Performance and Emerging Challenges.

ACDI/VOCA : ACDI/VOCA's greatest contribution to the field of microfinance is in the area of rural finance. It has three full-time staff working in the sector and a fourth one is anticipated. Rural finance has traditionally performed very poorly. Conditions in agriculture make it a difficult and dangerous sector to lend to. These conditions include seasonality of cash flow; high-risk based on the vagaries of nature and lack of crop diversification; inefficient production units; and longer-term loan requirements than traditional quick-turnaround micro loans. General rural conditions such as small-scale, dispersed clients and lack of infrastructure make even non-agricultural rural lending a challenge.

ACDI/VOCA has come to the fundamental realization that: "Just as agriculture is one key element of rural economic development, so agricultural credit is one financial service among many to be provided by a viable financial institution". They have developed a technology for rural finance which entails maintaining a commercial outlook, lending to off-farm microenterprise to diversify risk, in-depth assessment based on cash flow, pricing based on costs and risks, longer term loans and close supervision. This approach has been implemented in transforming several banks and upgrading Agrocapital from a "program" into a successful institution. Given that one of the major issues of microfinance is finding ways for institutions to reach more rural populations, ACDI/VOCA potentially has much to contribute.

CHF: CHF's primary contribution to the microfinance field is in meeting the challenge of providing credit for housing. While this is a cutting edge issue for many institutions, CHF has been involved in housing lending for over a decade. In the mid-1980's, CHF started housing credit schemes, making small, uncollateralized loans available to poor families for incremental housing improvements. The program initially used cooperatives, credit unions and other indigenous NGOs as intermediaries. CHF, using funds from the MacArthur Foundation, its own capital and money from other sources, lent funds to the NGOs for five years that were, in turn, on-lent to borrowers for 18-36 months. CHF's efforts included attempts to strengthen NGO capacity.

Other MFIs started providing (or are planning to provide) housing credit for shelter. These include the Grameen Bank, BRAC, BRI and credit unions. Diversifying the portfolio of these institutions is positive both for their clients and the institutions themselves. Since shelter loans differ greatly in size and term from traditional microfinance loans, and are for a "non-productive" purpose, new analysis tools are necessary. CHF has developed expertise in microfinance for housing that it is synthesizing and sharing with the broader PVO community. CHF developed a self-assessment tool for PVOs and NGOs to examine adding home improvement loans to their portfolios. This has led to a major collaboration with Plan International around credit for habitat.

In an evolution of its methodology CHF has expanded its lending programs to include microenterprise (particularly those operated by women or associated with housing). CHF is currently involved in microfinance in Asia, Latin America and the Middle East. CHF has studied best practices in the sector and its credit principles could be taken from any specialized microfinance PVO. It uses a variety of methodologies from providing guarantees to commercial

banks to working with village banks. CHF self-reports that 21% of its program is pure microenterprise.

NCBA : As a supporter of cooperative businesses, NCBA's role in rural credit has primarily been one of providing loan guarantees and intermediation. This comes from the belief that project-managed credit in West Africa can not become sustainable at the level of loan size needed by cooperatives in a reasonable period of time. Early on in its African experience, NCBA approached commercial banks. In Mali, five commercial banks dropped the guarantee fund after two years (the fund was never used) and entered into competition for the business of rural cooperatives. The banks have lent a total of several million dollars to co-ops with a 98% repayment rate.

Over time, NCBA has developed best practices for rural credit intermediation. It has also learned some interesting lessons on how to help cooperatives obtain credit in liquidity-starved financial systems with poor repayment records. This experience has been shared with the broader PVO/CDO community through its active involvement in SEEP, which is currently chaired by NCBA's Vice President of International Programs.

Another important area of intervention for NCBA is to provide support to the production and marketing (often export) of non-traditional agriculture. In El Salvador, Nicaragua and Indonesia, NCBA has worked with farmers in introducing certified organic products, particularly coffee. In El Salvador alone, over \$35 million of organic coffee has been sold by 69,000 farmers. In Indonesia, over \$300 million of foodstuffs have been exported by NCBA supported cooperatives to the US, Europe and Japan. In each case, there has been huge growth in income and employment. This is an important experience that is relevant to a number of PVOs including Save the Children and Technoserve.

Land O'Lakes: The fact that it is a functioning business rather than an apex or membership organization makes LOL unique among the CDOs studied. Land O'Lakes is a market and customer-driven cooperative committed to maximizing the value of its members' dairy, crop and livestock production. While many PVOs and CDOs seek to operate in a business-like fashion, LOL is a business. As a result, it actively explores commercial opportunities overseas including joint ventures, strategic alliances and direct supply agreements. Equity investment in a local institution in order to ensure a continued stream of technical assistance and adherence to jointly agreed upon operating principles is an issue many microfinance PVOs are grappling with.

Despite LOL's demonstrated capacity to help farmers capture value-added, increase income and contribute to economic growth, the focus of its work has actually been nutrition. The rationale is that families feed children first, then increase surplus and value-added for income. This gives LOL a lot in common with those PVOs practicing Credit with Education and attempting to influence the end use of income. LOL could serve as a contributor to discussions in this area.

Finally, before starting any program, LOL conducts a sector needs assessment. This involves heavy data collection in cooperation with host-country experts. The final assessment document

includes a comprehensive description of the agricultural situation, a detailed list of constraints to development, and a recommended action plan for accelerated, sustainable growth in the sector. Land O'Lakes' own business and marketing experience often leads to an industry-focused approach in which producers are effectively linked to processors. In fact, business linkages, technology, banking and finance, strategic alliances and labor are often networked across borders leading to a regional approach. These sector assessments can be shared (or be done jointly) with PVOs working with rural populations. The capacity to work across borders to pursue traditional trade patterns would be a big asset to microenterprise PVOs as well.

NTCA and NRECA: These two CDOs are grouped here because they are both involved in supplying infrastructure that is useful to microentrepreneurs. While improved communications and access to power for productive purposes are of undeniable value to microentrepreneurs, the precise impacts are deserving of further study. Both CDOs need to conduct baseline data studies, then evaluate the economic impact on members/subscribers of their services. NRECA must also disseminate its learning from "productive use" programs.

Telephones are a useful tool in business development services in that they can be used for marketing or gathering information (through the Internet). These tools are currently only available to urban elites. With the increasing interest of the microenterprise community in communications technology, NTCA must work with PVOs on developing financing mechanisms that incorporate lessons from microfinance to create institutions that provide telephone services in rural areas.

AAC/MIS: Many PVOs are realizing that microentrepreneurs need insurance to protect themselves and their businesses. Insurance can provide relief from the financial consequences of loss and backstop microenterprise institutions. Group-based insurance companies (e.g. credit unions, cooperatives and labor unions) have provided protection to microentrepreneurs who happen to be members of these groups for years. Yet microentrepreneurs have been reached only indirectly as members of insured groups. There has been no program, or product designed to met their specific needs. AAC/MIS has used USAID funding to do market studies of microentrepreneurs and there was broad acceptance of the need for insurance. The challenge for AAC/MIS and PVOs moving into insurance is an efficient delivery mechanism for an affordable product. AAC/MIS brings a lot to the table in this regard as is evidenced by their collaboration with La Equidad in Colombia.

Because of the disparate sectors and approaches described above, the CDOs need to spend a significant amount of time working on determining any commonalties. This is particularly true if they want to be regarded as players in microenterprise as a sector. Several CDOs seem to work more frequently with indigenous non-cooperative partners and seem more akin to PVOs. These discussions might take place either in OCDC or as a cooperative sub-group in SEEP. Either venue would help the CDOs examine common issues and approaches, and articulate their message to the external world better. The SEEP approach seems to have several advantages: 1) It would involve the Canadian CDOs in the discussions; 2) It would involve PVOs that are currently engaged in cooperative development; 3) It would provide a guaranteed audience in the PVO community; and 4) OCDC's role is primarily representational rather than technical.

3. Credit Unions as Microfinance Providers

Until there are clear distinctions between cooperative approaches and those of PVOs, the most useful comparisons are between credit unions and MFIs. Prior to doing fieldwork, the team reviewed the literature and interviewed as broadly as possible to determine people's opinions on the appropriateness of credit unions to serve as microfinance providers. What follows is a brief summary of what we were told:

Strengths

- Credit unions offer lending products that meet the basic criteria of microfinance: small loans, alternative guarantees, flexibility in the activities financed.
- Small-scale savings mobilization constitutes the main source of resources.
- They establish long-term relations with clients.
- They are not limited to poverty lending and have a broader financial base since they do not work exclusively with the poor.
- While they have not adequately reported on what portion of their loans are going to the microenterprise sector; they are clearly providing large amounts of credit to microenterprises. (John Magill's study for GEMINI several years ago estimated that they provide between \$150 million and \$300 million annually).
- In countries where WOCCU has implemented its "model credit union" approach, many credit unions are strong financially and specifically design products for their microenterprise clients.
- They often offer a broader range of products than specialized microfinance banks or PVO/NGO institutions.
- Central Liquidity Facilities allow excess liquidity in one credit to be moved to others.
- Significant experience in rural areas.
- Significant experience in insurance including bonding of employees and life savings.
- Many credit unions are regulated institutions.

Weaknesses

- Credit Unions are conservative institutions that only serve the middle-class.
- As a result, there is no growth or market orientation.
- They are borrower dominated and have unrealistically low interest rates.
- They have high delinquency.
- There are serious governance problems that are structural as well as individual.
- Previously acted as conduits for external credit with disastrous results.
- Second tier Federations are generally bloated bureaucracies that are not service-oriented or financially viable.
- Very few have developed more sophisticated services such as open-ended lines of credit, checking accounts etc.

What emerges is a picture of the different time periods during which various respondents worked with or observed credit unions, whether they were familiar with credit unions that had been used as channels for directed agriculture or community credit unions which had mobilized savings internally, whether they looked at aggregated statistics or individual best practice credit unions etc. Credit unions are very heterogeneous. They have a broad range of size, financial strength and diversity of products.

Are credit unions viable microfinance providers? As with previous work by Almeyda and Von Pischke, many respondents answered “yes” then proceeded to detail the challenges facing credit unions in their efforts to become even stronger microfinance providers. Other international development professionals criticize or ignore credit unions as viable microfinance providers. Yet credit unions continue to be successful financial intermediaries in lower income communities in developing countries.

To debunk some of the myths, our goals in the field study were to: 1) examine some of the critical issues raised by critics about credit unions as effective and viable long-term microfinance suppliers, 2) gather data and additional information on credit unions to help to evaluate these issues, and 3) identify best practices of credit unions that are competitive in microfinance.

PART II: THREE CASES IN MICROFINANCE DEVELOPMENT

Part II of the study summarizes the fieldwork conducted in Bolivia, Burkina Faso and Ecuador. The three countries provided different environments in which to study commonly accepted “best practices” in developing and strengthening microfinance institutions, both in terms of the macroeconomic situation and the degree of commercialization of the microfinance sector.

Bolivia and Burkina Faso are two of the poorest countries in the world. With a per capita income of \$800, Bolivia remains one of the poorest countries in Latin America as measured by most economic and social indicators.¹⁴ Seventy-five percent of its population is poor. Burkina Faso, with a per capita income of \$300, is among the poorest and more densely populated countries in sub-Saharan Africa. In contrast, Ecuador has lower levels of poverty. Thirty-five percent of the Ecuadorian population lives in poverty and an additional 17 percent is vulnerable to poverty.¹⁵ As in Bolivia, the incidence of poverty varies considerably between urban and rural areas and the income distribution is highly skewed.

The three countries present different levels of development of the microfinance industry and its commercialization as well. Bolivia is characterized by advanced MFIs in a dynamic, mainly urban market. Ecuador is characterized by less-developed MFIs also in urban settings. In contrast, the development of MFIs in Burkina Faso is concentrated in rural areas.

In all three countries, microenterprise constitutes a major source of household income for over 50 percent of the economically active population. Therefore, in each case, access to microfinancial services is a key factor in supporting the development of their business and household investment and survival strategies. Bolivia, however, has attained the highest level of success in the sector, becoming a laboratory for MFIs and programs that reach hundreds of thousands of families, according to estimates. One purpose of the field visits was to examine what factors have led to this success.

Each country provided case studies of MFIs supported by PVOs and CDOs. While there have been a number of extensive reviews of PVO microfinance activities, the microfinance initiatives of CDOs have received relatively little attention. Moreover, performance information for many of the MFIs linked to U.S. PVOs is available through the MicroBanking Bulletin.¹⁶ Therefore, we have focused primarily on credit unions and other microfinance programs linked to CDOs.

In Bolivia and Ecuador, credit unions are currently receiving technical assistance in institutional strengthening from WOCCU, with a special component in microenterprise credit in Ecuador. Bolivia also provided an opportunity to examine Agrocapital, an MFI receiving support from ACIDI/VOCA. In Burkina Faso, a highly innovative and successful experiment is currently being executed as a hybrid program between credit unions and village banks with the support of Freedom from Hunger.

¹⁴ The World Bank. Bolivia: Poverty, Equity and Income-Selected Policies for Expanding Earning Opportunities for the Poor, 1996.

¹⁵ The World Bank. Ecuador Poverty Report, 1996.

¹⁶ The MicroBanking Bulletin, Issue No. 2, July 1998. Currently published by Calmedow, Washington, D.C.

In each country, we selected USAID/BHR/PVC grantees¹⁷ and focused on:

- **Organizational structures and methodologies that serve various populations more effectively.**
- **Building local institutions to deliver services:** examining the scope and sustainability of the institutions, both financially in terms of cost recovery, and institutionally in terms of longevity and independence from donations/subsidies.
- **The type of clients and the impact of receiving financial services.**
- **Lessons learned, best practices and key issues.**

¹⁷ In general, these grantees have also received support from other donors and USAID, not merely USAID/BHR/PVC.

CHAPTER III: THE CASE OF BOLIVIA: AN ADVANCED COMPETITIVE MICROFINANCE MARKET

A. THE LOCAL MICROFINANCE SECTOR

Just over a decade ago, the Bolivian financial sector was quite weak. Banks and other formal financial institutions were bankrupt and non-bank, unregulated institutions such as credit unions almost disappeared as triple digit inflation reduced the value of their savings drastically. For the last decade, USAID and other donors have supported the strengthening of the Bolivian financial sector. Over time, this has made Bolivia a showcase of successful microfinance institutions.

The weakness of Bolivian financial institutions was not only due to hyperinflation and the tin crash of the mid-1980s. It was also due to poor management practices on the part of financial institutions—lack of prepared and professional staff, inefficiencies in operational and technical processes, absence of sound policies and procedures and lack of control tools and management information systems (MIS).

After a decade of major economic and financial reform, Bolivia's economy has stabilized. The financial sector has become more solid and competitive. The Banks and Financial Institutions Law of April 1993 introduced the concept of multibanks, granting authorization to financial institutions to operate with different financial services, one of them being credit for microenterprise activities.¹⁸ This Law specifically incorporated “non-bank financial institutions,” including credit unions, which came under the supervision of the Superintendency of Banks and Financial Entities (*Superintendencia de Bancos y Entidades Financieras*, or SBEF).¹⁹ Later in 1995, the government issued a decree approving the establishment and operations of private financial funds—*fondos financieros privados*, or PFFs in Spanish—regulated by the SBEF and authorized specifically to direct resources to small and micro-borrowers in urban and rural areas.

According to the Bolivian Superintendent of Banks, Mr. J. Trigo, as of mid-1998 the regulated financial system included banks with total assets amounting to \$5 billion and non-banking financial institutions with \$923 million (including BancoSol). There were 564,775 borrowers under the regulated institutions, of which 60 percent were served by the non-banking sector. Among the non-banking institutions, the *mutuales* are mainly in housing finance of medium-income wage-earning sectors. Thus, according to the Superintendent, credit unions and PFFs (including BancoSol) finance 54 percent of loans of the regulated financial system and 9 percent

¹⁸ J. Trigo Loubiere, “Supervision and Regulation of Microenterprise Financial Institutions: Bolivian Experience.” Superintendency of Banks and Financial Institutions, September 1998. Paper prepared for the Second Annual Seminar on Development Finance, Frankfurt, Germany, September 1998.

¹⁹ The law applied to *open bond* credit unions, those serving members and non-members. *Closed bond* credit unions serve a group linked by a common bond, such as place of employment (e.g., a factory) or common trade (e.g., taxi drivers). Currently, three credit unions are licensed by the SBEF and 17 other that currently report to the SBEF are waiting for approval. The licensed credit unions are: Jesus Nazareno, Financiacoop and San Antonio Credit Union.

of the loan portfolio. The conclusion is that the institutions we studied give a large number of relatively small loans.

B. ANALYSIS OF A SELECTED GROUP OF MFIs

1. Institutional Structure

The fieldwork in Bolivia compares credit unions and other CDO-supported institutions (i.e., Agrocapital) with some of the MFIs that have been supported by PVOs and covered in the *Best Practice* microfinance literature review. Considerable data already exists for these MFIs.²⁰ The table includes a description of the date founded, the institutional structure and lending methodology, the ownership, and the PVO/CDO affiliation.

The selected group of institutions studied includes:

- BancoSol, evolved from a microenterprise NGO and is now the leading microlender in Latin America,
- Caja Los Andes and FIE, two PFFs that evolved from NGOs into fully regulated non-bank financial intermediaries,
- PRODEM and Agrocapital, two NGOs that are currently converting into PFFs,
- CRECER, an NGO that uses credit associations (also known as village banks) with a health education methodology; and
- Two credit unions: the largest in the country, Jesus Nazareno Credit Union (JNCU), and a small one, Montero Credit Union.

As of December 1998, the selected group of MFIs combined total assets of \$257 million, total outstanding loans of US\$205 million, total deposits (savings passbooks and fixed-term deposits) of \$123 million, and total equity of \$57 million. These resources provide evidence of the advanced nature of Bolivian MFIs, a heterogeneous group of institutions both regulated and unregulated by the SBEF using proven and successful lending methodologies.

The credit unions provide cases of two different levels of operations. JNCU is the largest credit union in the country, while Montero is the smallest one associated with the WOCCU credit union strengthening program. JNCU is one of the three credit unions that received a license (or authorization) to operate under SBEF in 1993. Montero is one of the 17 credit unions that officially report to the SBEF, but it is still waiting to receive formal authorization.

A key issue to be addressed in this study is identification of lessons and practices derived from credit unions that are currently participating (or want to strengthen their participation) in the financial market. Credit unions such as JNCU have already built a critical mass of members, loans, deposits and equity, thereby helping to expand the current frontier of microenterprise. The issue at stake is not how to build new credit unions, but how to build on solid existing ones.

²⁰ Current data are available on the Web, as well as from MicroBanking Bulletin, Microfinance Network, Rating Agency and several other studies.

2. Outreach: Credit

a. Scale of Outreach

The combined loan portfolio of the eight MFIs amounted to \$207 million. This served over 273,000 clients at the end of 1998 (Table 3.1). Four institutions: BancoSol, JNCU, Caja Los Andes and FIE serve primarily an urban clientele and constitute 75 percent of the total number of clients and 81 percent of the loan portfolio. The other four: PRODEM, Agrocapital, CRECER and Montero Credit Unions operate primarily in rural areas and have 25 percent of the clients and 19 percent of the combined loan portfolio.

Table 3.1 Bolivia : Selected MFIs - Scale and Depth of Outreach: Credit As of December 31, 1998 (US\$000)							
MFIs	INDICATORS OF SCALE				INDICATORS OF DEPTH		
	Number of Clients	Value of Outstanding Loans US\$ (000)	Number of Branch Offices	Average Number of Clients per Branch	Average Outstanding Loan Size	Loan as a % of GDP per Capita \$942	% of Women Clients
BancoSol	81,555	\$71,309	40	2,039	\$874	113%	70%
Caja L. Andes	34,913	\$28,617	10	3,491	\$820	87%	58%
PRODEM	45,501	\$23,632	50	910	\$519	53%	67%
FIE	20,848	\$14,087	14	1,489	\$676	\$72%	65%
Creceer	12,724	\$2,026	(1) 20	636	\$159	19%	96%
Agrocapital	4,436	\$11,736	10	444	\$2,646	281%	(2) 65%
J Nazareno	Members 66,821 Borrowers 18,871	\$52,923	14	5,569 1,572	\$2,804	298%	54%
Montero CU	Members 6,867 Borrowers 2,027	\$3,544	4	1,717 506	\$1,749	186%	47%
Total Group	273,665	\$207,873	163				
	100%	100%	100%				
J. Nazareno's Share of Total	24%	25%	7%				

Note: (1) Number of departmental provinces where Creceer has programs with 615 credit associations (village banks).
(2) % participation of women in microloans.

The CDO supported institutions are obviously major players in the sector. With almost 67,000 members; 19,000 borrowers, and \$53 million in loans, JNCU is the second largest institution of all. Agrocapital and Montero add still further to these totals and it is important to note that there are 18 other large credit unions that are part of the WOCCU project.

It can be argued that while the specialized MFIs (BancoSol, Caja Los Andes, FIE, PRODEM and CRECER) target microentrepreneurs, the credit unions have a broader membership of both entrepreneurs and low-wage employees, whose households generally include members in entrepreneurial activities. Yet, fifty-three percent of JNCU members and 86 percent of Montero Credit Union members have as their primary occupation microenterprise activities. These credit unions also provide services to low-income wage earners (e.g., rural teachers, factory workers) that borrow for housing and human investments such as higher education of their children.

b. *Depth of Outreach*

The average size of outstanding loans (Table 3.1) offered by the MFIs varies between urban and rural lenders. As expected, the urban lenders have larger average sizes: ranging from FIE's \$676 to JNCU's \$2,804. The average loan of the rural lenders varies from CRECER's low of \$159, to Montero Credit Union's \$1,749 and Agrocapital's \$2,646.

The three cooperative institutions had the three highest average loan sizes. This does raise questions about depth of outreach and one must look for explanations as to why this may be so. Agrocapital's higher average size results from a percentage of its portfolio invested in small and medium agrobusinesses. The larger average size of JNCU and Montero Credit Union loans results from a percentage of its portfolio invested in housing.

The average loan size of all institutions has increased over recent years as a result of enhanced creditworthiness of repeat borrowers and because services are offered to a broader group of microentrepreneurs (Table 3.2). The non-cooperative microfinance institutions have significantly raised their average loan size in an effort to diversify their customer base (i.e. become more like credit unions). In one case loan sizes were more than tripled. At the same time, Jesus Nazareno has made a concerted effort to move down market by adopting a solidarity group methodology.

Table 3.2: Average Outstanding Loan Size, 1996-1998, US\$			
MFIs	1996	1997	1998
BancoSol*	\$661	\$828	\$914
Caja Los Andes*	\$280	\$692	\$892
FIE*	\$549	\$540	\$676
PRODEM**	\$301	\$478	\$519
*Source: Private Sector Initiative Corporation.			
**Source: PRODEM.			

In recent years, the selected MFIs concentrated on smaller loans (under US\$500). However, as shown in Table 3.3, the range distribution reflects an increasing number of larger loans. The credit unions' loan portfolio reflects a more diverse distribution of ranges, but still with 89 percent of their loans under US\$5,000. Women were also roughly half of credit union membership.

Table 3.3: Comparison of the Distribution of the Number of Outstanding Loans				
Range in US\$	BancoSol 1/31/99	Caja Los Andes 12/31/98	JNCU 12/31/98	Agrocapital 12/31/98 (based on volume)
Less than 500	29%	40%	13%	3%
500-1,000	28%	27%	15%	6%
1,000-2,000	22%	17%	23%	
2,000-5,000	18%	11%	38%	29%
5,000-10,000	2%	4%	7%	15%
Over 10,000	1%	0.4%	4%	47%
Total	100%	100%	100%	100%
Source: Table prepared with data provided by the institutions.				

c. *Quality of Outreach*

The group of MFIs offers a variety of loan products, thereby improving the quality of products offered in the local microfinance market. Improvements in quality are evidenced by:

- **Interest Rates:** Interest rates are becoming lower as MFIs become more efficient in a highly competitive local microfinance market where clients choose among many options.
- **Lending Methodologies:** Individual loans are offered now by BancoSol, Caja Los Andes, FIE, Agrocapital and the two credit unions. Group lending is available not only from BancoSol and PRODEM, but also from the two credit unions. JNCU has over 2,200 solidarity groups and Montero CU began solidarity groups in December 1998. CRECER uses credit associations (some 25 members per group) to reach the poorest groups. According to Caja los Andes, the individual lending methodology allows major flexibility to the specific cash flows and diversity of economic activities of rural borrowers.
- **Loan Sizes:** While Bolivian microentrepreneurs were previously limited to very small loans mainly for short-term working capital, they now have access to a broader range of loan sizes. BancoSol, for example, now offers individual loans with solidarity group guarantees that can be as high as \$6,000, and individual loans with collateral of up to \$30,000. Similar loan sizes are available from the other MFIs (except for CRECER, which focuses on poorer borrowers). Caja los Andes is also offering larger loans. The credit unions have a broad range of loan sizes. Agrocapital offers larger size loans for agricultural activities with flexible payments tailored to production.
- **Guarantees:** Non-traditional guarantees are available from specialized MFIs. The credit unions have added group lending to their traditional personal guarantee loans (co-signers). Poorer clients find this advantageous because it is easier for them to find other microentrepreneurs who are willing to guarantee each other as borrowers.
- **Loan Terms:** Terms were previously concentrated in less than six months. Now clients find a variety of loan terms. Caja Los Andes now has 42 percent of loans over 12 months, while in 1996 only 10 percent of its loans were over 12 months. Agrocapital has 38 percent of its loan portfolio over three years. The longer-term loans support larger investments for fixed assets. Short-term financing continues to be available from all the institutions. According to specialized MFIs, some of the commercial financing companies, which are new entrants in the consumer lending market, are offering micro credit with three year terms, but at very high interest rates.
- **Technical Staff in Microenterprise Lending:** All the specialized MFIs already had a technical staff in microenterprise lending. The two credit unions have hired staff with specific microenterprise expertise. JNCU has 21 microenterprise credit analysts who constitute the majority of the credit staff. While this caused some initial adjustment within the institution,

this microenterprise staff is now fully integrated. Agrocapital specializes in lending for agricultural activities but is increasing its microfinance loan portfolio.

3. Outreach: Savings

As of December 1998, the total deposits mobilized by the group of MFIs amounted to \$124 million. BancoSol and the PFFs (Caja Los Andes and FIE) mobilize large institutional fixed-term deposits. In contrast, the two credit unions offer savings passbooks. JNCU offers savings passbooks to 66,821 members, and Montero Credit Union to 6,887. The average savings balance in JNCU is \$300, and \$114 in Montero Credit Union. Ninety-three percent of JNCU's saving accounts are less than \$300. The credit unions demonstrate that they have a comparative advantage in offering small savings passbooks. These savings passbooks offer competitive market interest rates.

It is worth mentioning that JNCU and Montero Credit Union were able to recover from the crisis of the 1980s, when the value of their assets and capital plummeted. The fact that they have been able to grow again to the current levels is evidence of their viability as providers of financial services to large numbers of low-middle and low-income borrowers and depositors. These users are also shareholders who have invested their own capital in order to secure access to financial services.

Table 3.4 Bolivia -- Selected MFIs -- Scale and Depth of Outreach: Savings As of December 31, 1998 (US\$ 000)								
MFIs	Clients Savers	Number of Branches	Volume of Demand Deposits (Savings Passbooks) (\$000)	Volume of Fixed Term Deposits (\$000)	Total Volume	Average Savings Passbook Balance	Savings as a % of GDP per Capita	% of Women Clients
BancoSol	2,998	41		\$56,109	\$56,109			
Caja L. Andes		10		\$10,544	\$10,544			
FIE		14		\$7,365	\$7,365			
Crecer	12,863	(1) 20	\$505		\$505	\$39	4%	96%
J.Nazareno CU	66,821	12	\$20,733	\$25,696	\$46,429	\$310	33%	54%
Montero CU	6,887	4	\$782	\$2,384	\$3,166	\$114	12%	47%
Total Group	89,569	101	\$22,021	\$102,098	\$124,118			
	100%	100%	100%	100%	100%			
J. Nazareno's Share	74%	12%	94%	25%	37%			
Notes: (1) Number of departmental provinces where Crecer has programs with 615 credit associations (village banks).								

4. Sustainability: Financial and Operational Performance

a. *Financial Structure*

The high level of the MFIs' deposits and loan obligations reflects the confidence of depositors and lenders in the financial strength of these institutions. As of December 1998, the total assets of the selected group of MFIs reached \$267.7 million. Banco Sol has by far the highest assets, with Jesus Nazareno Credit Union second and Montero Credit Union last. With Montero chosen specifically to be representative of small credit unions, this is not surprising. The two credit unions had the highest percentage of their assets in loans and the highest percentage of deposits as portion of equity. The NGO MFIs have built their equity with donations and retained earnings; the regulated financial intermediaries have been able to leverage their equity with loan obligations; and credit unions have done it with members shares and undistributed dividends.

b. *Financial Performance*

The solid financial performance of the specialized MFIs in Bolivia is well known in the microfinance community. These institutions are considered best practice cases.²¹

Loan Delinquency: A key indicator of their financial performance is their low delinquency ratio. High payment rates reflect client satisfaction and close monitoring of the loan portfolio. Delinquency rates over one day are close or under 5 percent. JNCU has a larger delinquency rate of 6.5 percent for loans over one day and 4.4 percent for loans over 30 days. According to JNCU, which operates primarily in Sta. Cruz, this is mainly the result of the "samba" effect from the Brazilian crisis. According to recent reports by the SBEF,²² at the end of February 1999, the banks' average loan delinquency had increased from 4.8 percent in December 1998 to 10.4 percent at the end of February.

In addition, and as identified by the other MFIs, in early 1999, borrowers were experiencing over-indebtedness. As expressed by most of them, some of the PFFs specializing in consumer lending were trying to reach lower market segments and were using aggressive marketing schemes with low quality in analyzing the payment capacity of the borrower.

Financial Self-Sufficiency: All the institutions, except for CRECER, produced revenues sufficient to cover their operational and financial costs. CRECER is close to financial self-sufficiency with a ratio of 98.6 percent. Montero Credit Union has a ratio of 101 percent, JNCU has 107% and Agrocapital was highest of all at 122%.

²¹ Reports on the performance of BancoSol, PRODEM, Caja Los Andes, FIE and CRECER were presented in the Second Annual Seminar on New Development Finance in Frankfurt, September 1998, organized by IPC, Development Alternatives, Inc. and The Ohio State University with the support of USAID. Financial performance indicators are available from the Microfinance Network (Washington, D.C.), from the Private Sector Initiatives Corporation (Washington, D.C.) and from the MicroBusiness Bulletin (published by Calmedow, Washington, D.C.).

²² *Nueva Economia*, La Paz, March 22-28, 1999, p. 16.

Table 3.5 Bolivia : Selected Group of MFIs --- Financial Performance As of December 31, 1998				
MFIs	Delinquency over One Day	Return on Average Total Assets	Return on Average Equity	Operational and Financial Self-Sufficiency
BancoSol	4.5%	3.8%	25.6%	115%
Caja L. Andes	5.6%	3.3%	27%	113%
PRODEM	(1) 3.1%	(2) 6.7%	15.7%	122%
FIE	4.5%	2.6%	16.8%	114%
Creceer	1.5%	(3)	(3)	98.6%
Agrocapital	4.5%	4.5%	7.9%	122%
J.Nazareno CU	6.5%	1.7%	11.9%	107%
Montero CU	2.7%	0.3%	2.1%	101%

Notes: (1) PRODEM's delinquency rate is for over 30 days due.
(2) With extraordinary gains (sale of BancoSol stock), PRODEM's return on total asset is 10% and the return on equity 23%
(3) Creceer had a deficit of \$49,362.

Growth: The growth rates of all MFI loan portfolios decreased during 1998 (Table 3.6), except in the case of CRECER. The lower growth rates as compared to those of 1997 reflect increasing competition among various suppliers of microfinancial services and deteriorating economic conditions ("samba effect," floods).

Table 3.6: Loan Portfolio Growth (Volume) 1997-1998								
Year	BancoSol	Caja Los Andes	PRODEM	FIE	Agrocapital	CRECER	JNCU	Montero CU
1997	33%	238%	123%	58%	18%	41%	45%	62%
1998	17%	40%	28%	16%	4%	91%	18%	11%

The growth of savings in the specialized MFIs (BancoSol, Caja los Andes) shows their increasing capacity and strategy to capture deposits from institutional investors. BancoSol and Caja los Andes are still in the process of developing low-cost efficient systems for small savings passbook accounts.²³ In 1997, Caja los Andes expanded deposit mobilization services from three to all agencies, an expansion demonstrated by its large growth indicator (see Table 3.7). In contrast, the credit unions which mobilize small savings from middle- and low-income individuals are being affected by adverse economic factors and decreasing liquidity in the market during 1998.

Table 3.7: Deposits Growth (Volume) 1997-1998				
Year	BancoSol	Caja Los Andes	JNCU	Montero CU
1997	17%	2%	46%	52%
1998	20.5%	187%	13%	0.3%

²³ After receiving the approval to operate as FFP in 1998, the SBEF only allowed it to mobilize fixed term deposits. FIE only captures deposits in La Paz.

c. Operational Efficiency

Number of Loans per Credit Officer: Each selected MFI has a minimum of 200 loans per credit analyst, reflecting advanced levels of operational efficiency. JNCU has 629 loans per loan analyst. Such a high average could also reflect lack of sufficient personnel to manage credit portfolios adequately. This high loan to analyst ratio may be one of the causes of a higher delinquency ratio as compared to specialized MFIs. Agrocapital has the lowest number of loans per credit staff and the second highest volume of outstanding loans per credit staff. This is indicative of its relatively large loans and the amount of analysis it does.

The test in the Bolivian microfinance market has been sustainable: financially, in terms of cost recovery, and institutionally, in terms of longevity and ability to maintain self-sufficiency and access to resources using commercial mechanisms. The specialized MFIs have been able to grow steadily, cover their operational and financial costs and gain a high return on equity. JNCU shows solid financial and growth indicators.

C. THE DEVELOPMENT OF A LEVEL PLAYING FIELD IN THE LOCAL MICROFINANCE MARKET

This section summarizes the key issues, best practices and lessons learned about the impact and sustainability of the broad spectrum of approaches applied in Bolivia by the selected group of MFIs linked to CDOs and PVOs funded by USAID/BHR/PVC.

In countries like Bolivia, where MFIs are more advanced, how can donors, specifically USAID/BHR/PVC, contribute to develop a level playing field in the local microfinance market among various participants (i.e., banks, FFPs, credit unions, NGOs)? Currently, the international development community is proposing the development of a *microfinance industry*. How can the study of Bolivia contribute to understanding the challenges from a variety of perspectives?

1. The Credit Unions

A key issue for the international microfinance community is how to build on the institutional capacity that already exists in some credit unions, rather than propose credit unions as a model to begin new microfinance efforts. Jesus Nazareno and Montero credit unions provide useful cases to identify practices, lessons, and key issues relevant to the development of competitive microfinance markets in developing countries.

a. Lessons

- Credit unions offer the type of products (both savings and credit) that meet the needs and characteristics of microentrepreneurs and other low-income groups. The average size of credit and savings is appropriate, the loan terms and interest rates are competitive and expand the frontier of finance. The scope of outreach is large and has the possibility of expansion. Credit unions offer their clients a variety of financial services and delivery mechanisms.

- Support from WOCCU has contributed to strengthening the institutional and financial capabilities of individual credit unions. WOCCU is currently providing technical assistance to 20 credit unions. According to PERLAS indicators, at the end of 1998 this network of credit unions served 260,172 members with outstanding loans of \$173.5 million financed mainly with their own savings of \$170 million and \$7.1 million of institutional capital (does not include their own share capital).

b. *Best Practices*

- Credit unions such as JNCU and Montero CU have added the use of solidarity groups to their individual lending methodology. They have seen from other MFIs that solidarity groups help to reach poorer people and therefore, they adopted it. They did it by hiring personnel with experience in BancoSol. The credit unions provide evidence of the dissemination of group practices through market mechanisms. This model which has been developed by JNCU in the Sta. Cruz department could be used as a best practice example for other credit unions. It fundamentally debunks the myth that credit unions are conservative middle-class institutions that don't care about the "riffraff".
- Solidarity group methodology is seen by the credit unions also as a way to get a new type of guarantor to their traditional "personal guarantees." Members who could not find personal guarantors with adequate debt capacity, use the solidarity groups because the individuals in the groups (who are also "personal guarantors") can understand better their own needs and are more willing to guarantee each other.
- JNCU and Montero credit union are the only MFIs studied that are actively mobilizing small savings. The experience of credit unions can help the sector understand the dynamics of this type of service, considered by other MFIs as costly and difficult to implement. The strategy of the credit unions has been to improve their ability to compete in the mobilization of small savings, usually monopolized by one or two banks. In contrast, MFIs such as BancoSol and the FFPs are mobilizing large institutional deposits.
- Credit unions have a variety of savings and credit services that are more adaptable to both the household and business investment strategies of low-income people. Clients can save and borrow in the same institution. JNCU and Montero CU are adding to market diversification. Poor households combine sources of income and include low-waged jobs with microentrepreneurial activities.

c. *Limitations*

- The group of credit unions currently receiving technical support from WOCCU lacks a "system or network" approach to their sector. This limits their ability to use their critical mass of members, infrastructure, funds mobilized etc. in a way that strengthens them in their competition with other MFIs. Although each credit union could be seen as a separate MFI, they can become more competitive with a system approach.

- Currently, the SBEF is in the process of determining which credit unions are going to be licensed as financial intermediaries. JNCU is one of the three that already have been authorized by the SBEF. Smaller credit unions such as Montero CU are not developing the "system" approach or are reluctant to integrate to larger credit unions.

d. *Strengths*

- The credit unions have a critical mass. Currently there are 17 credit unions that report to the SBEF. They already have standard accounting and reporting systems. In addition, the technical assistance provided by WOCCU has established the PERLAS system, which in addition to providing monitoring and performance indicators, can be used as a managerial and planning instrument. The 20 credit unions under the WOCCU project have a total of 66 branches, 28 of them in rural areas and operate in several departments other than La Paz where most specialized MFIs already have branches.
- Credit unions such as JNCU and Montero were able to come back after the financial crisis of the early 1980s. One can say that they have had to begin all over again. Many of the FFPs and NGOs in Bolivia today never had to weather that crisis. Most of the financial NGOs from that time are no longer in operation. When compared to other MFIs, credit unions show evidence of the acceptance they have in their own communities. They provide another model of microfinance: the institutional model based on mobilizing local savings and equity shares.
- JNCU and Montero CU demonstrate that credit unions can change their practices and move from a volunteer-managed institution to a professionally managed, competitive financial intermediary. Credit unions such as JNCU meet current microfinance performance standards of outreach and financial viability.
- Although credit unions operate mainly at the local level, those that develop their institutional capacity can expand. JNCU has opened branches in various urban, peri-urban and rural areas of the department of Sta. Cruz and more recently in Beni and Pando.
- Adequate regulation contributes to strengthening the credit unions as well as providing external monitoring. Changes in areas that are considered weak in credit unions have been made as a result of appropriate regulation. The regulatory framework contributes to compensating for the difficulty of maintaining an informed membership with an increasing number of shareholders, who are not well informed and lack the ability to exercise adequate governance.

e. *Key Issues*

- Credit unions need to be invited to participate in networks, conferences, etc. dealing with microfinance industry issues. There are areas for cooperation among MFIs, such as central risk facilities, access to technological innovations that reach lower income groups etc.

- The lessons from the "camba" model which uses solidarity groups to reach out to poorer segments of society needs to be shared among other credit unions with the interest and the institutional capability to compete in microfinance.
- The participation of credit unions as microfinance providers requires that an institution such as WOCCU can learn from the camba model and disseminate it to other credit unions. This will add value to the already successful TA provided by WOCCU.

CHAPTER IV: THE CASE OF ECUADOR²⁴

In contrast to Bolivia, which is currently in a stable economic and financial period, Ecuador has been suffering in recent years from financial, economic and political crises. At the end of 1998, inflation reached 43 percent and annual average GDP about one percent. The negative economic and financial environment affects the economic activities of the poor. Traditionally, Ecuador has been a country characterized by a dynamic informal and microenterprise sector.

After a brief introduction to microfinance in Ecuador, this section presents the case of a group of institutions that are providing microfinancial services. These include MFIs linked to U.S. PVOs and CDOs:

- Banco Solidario and the Ecuadorian Development Foundation (FED), which have worked with ACCION International,
- Village bank programs supported by FINCA and Catholic Relief Services,
- Two credit unions, Progreso (Quito) and 23 de Julio Credit Union (Cayambe), which are currently participating in a technical assistance project supported by WOCCU.

A. THE LOCAL MICROFINANCE SECTOR²⁵

1. The Ecuadorian Poor

According to the World Bank (1996), four million Ecuadorians, approximately 35 percent of the population, live in poverty. Fifteen percent of the population lives in extreme poverty and cannot meet their nutritional requirements (Table 4.1). There are larger numbers of rural poor than urban poor. Sixty percent of the poor, 2.3 million people, live in rural areas. Rural poverty is associated with lack of education, little access to land, low degree of market integration and lack of employment in the off-farm rural sector. The eastern jungle provinces suffer the highest levels of poverty. Poverty is also higher among the indigenous population of the Sierra and Amazon regions. The indigenous population shows higher levels of malnutrition, higher child mortality and lower levels of education.

Table 4.1: Poverty in Ecuador 1994: Summary Measures			
	Vulnerable	Poor	Extremely Poor
Urban	40%	25%	10%
Rural	67%	47%	22%
National Total	52%	35%	15%
Source: World Bank, <i>Ecuador Poverty Report</i> , 1996. Table 1, p. 4.			

²⁴ The consultant team visited Ecuador from March 10 to March 16. During this week, the President ordered banks to close in order to avoid a major financial panic. Streets were closed as a result of taxi driver strikes. The scheduled visits for our study had to be rearranged and some took place as the MFIs were dealing with emergency measures to respond to their clients. We are immensely grateful to the staff of the selected MFIs, who made every effort to meet with us. We were unable to ask for detailed data on their operations because it would have required additional time and effort from their personnel in a very difficult time.

²⁵ This section is drawn from G. Almeyda and B. Branch, "Case Study of Two Ecuadorian Credit Unions-OSCUS and Progreso," prepared for *Sustainable Banking with the Poor*, The World Bank, 1998.

2. The Microenterprise Sector—Initiatives in Microenterprise Development

During the past decade, international donors, government, private banks, a number of NGOs and credit unions have been involved in microenterprise credit. The Ecuadorian microenterprise sector has been characterized by its dynamism. Almost 40 percent of Ecuador's urban economically active population (EAP) are involved in microenterprise-related activities (Secretaría Técnica del Frente Social, 1996). In rural areas, about 27 percent of the EAP work in off-farm economic activities as their primary occupation and 45 percent work in off-farm activities as their secondary occupation. The economic endeavors of both urban and rural populations encompass a heterogeneous sector of micro- and small enterprises, *famiempresas* (family-based businesses) and self-employment. In the early 1990s, the number of micro- and small enterprises in Ecuador was estimated between 250,000 and 300,000. These establishments employed 67 percent of the population with less than five employees.²⁶

As in other Latin American countries, the main sources of credit for Ecuadorian micro-entrepreneurs are informal—savings, relatives, friends and moneylenders (Moser, 1996, p.130). In her research in Dos Cisnes (Guayaquil), Moser found that nearly half (45 percent) of households surveyed borrowed money during the year of interview (1992). A third of these borrowed from neighbors, a quarter from family and the rest from other sources, such as work contracts and employers.

a. NGOs

The Ecuadorian microenterprise sector has received increased support and attention in the past decade. The GEMINI study (Magill and Swanson, 1991) indicated that at the time:

- There were more than 10 international donors, three government ministries and 30 local institutions involved in providing resources and support to the micro- and small enterprises.²⁷
- There was a lack of comprehensive national microenterprise strategy with widespread disenchantment among financial institutions and NGOs.
- More than 30 NGOs were exploring different strategies to reach micro- and small clients, but only 10 NGOs had a solid track record in working with these clients.
- NGOs had low levels of sustainability and were dependent on single sources for their funding.

In 1993, a group of NGOs formed a credit guarantee corporation, CORPOMICRO. During 1994, CORPOMICRO extended 1,240 guarantees valued at US\$1.1 million (average US\$840).

²⁶ J. Magill and D. Swanson (1991). The study surveyed small businesses with 1-12 employees, 75 percent of them with total assets of less than \$5,000.

²⁷ International agencies included the World Bank (small and medium enterprises), IDB, Swisscontact, Konrad Adenaur Foundation, GTZ, USAID and the Inter-American Foundation. The ministries were Labor, Social Affairs, Small Industry and Handicrafts.

According to the *Corporación Financiera Nacional* (CFN),²⁸ CORPOMICRO currently has about US\$4 million in its loan portfolio. Among the NGOs that form CORPOMICRO today are Insotec, Corfec, Eugenio Espejo and Fundación Autoempleo.

b. Credit Unions

According to Magill and Swanson,²⁹ the Ecuadorian credit union movement, although weak, was the major lender for small-scale enterprise activity in the country in the beginning of the 1990s. They estimated that credit unions lent small enterprises an average of US\$10-US\$15 million per year from their own locally generated resources and that credit unions were self-sufficient.

In 1996, WOCCU surveyed members of 11 credit unions with a total membership of 253,004 throughout the country.³⁰ The survey results indicated that these credit unions provided services to the low- and lower-middle-income segments of the Ecuadorian population. The study also found that the credit unions played an important role in the provision of financial services to micro- and small business owners. More than 52 percent of member households (credit union members and their spouses) owned and operated a business. These enterprises averaged two permanently employed persons. More than half of the businesses provided regular employment for only one person.

c. Commercial Banks

Compared to other Latin American countries, Ecuadorian commercial banks have been more heavily involved in small enterprise finance. Since 1978, the Banco del Pacífico has led efforts to supply credit particularly targeted to microenterprise with a program called Programa de Promoción de la Comunidad. As of December 1993, the outstanding loan portfolio of the Banco del Pacífico program was \$2.1 million. Banco Popular and Banco Progreso are other banks that have participated in government or NGO microenterprise programs. In August 1996, a new bank was created that specializes in microenterprise finance: Banco Solidario. This bank was established by Grupo Enlace, whose investors include local individuals, NGOs and international investors such as Pro-Fund, Seed Capital Development Fund and the Andean Financial Corporation. Grupo Enlace also receives support from USAID for technical assistance.

The Ecuadorian banking system has been undergoing a major crisis and some banks are in a process of restructuring to respond to their deteriorating condition. Others, such as the largest bank in deposit mobilization, Filanbanco, are currently under the national deposit guarantee agency. In a public opinion survey at the end of 1998, 46.6 % of respondents indicated they “did not believe in any bank” and 37.5 % felt that banks were not secure.³¹

²⁸ Team interview with the CFN's Subgerencia de Desarrollo de la Pequeña y Microempresa.

²⁹ J. Magill and D. Swanson. *Ecuador Micro-Enterprise Assessment Report*. GEMINI Technical Report No. 9, 1991, p. xii.

³⁰ D. Mesbah. *The Role of Credit Unions in Ecuadorian Financial Markets: A Case Study of 11 Credit Unions*. WOCCU, 1997.

³¹ M. P. Vela and V. Brito. *Reporte Macroeconomico*, No. 61. Quito: Multiplica. Diciembre 1998, p. 61.

d. Government Microenterprise Programs

The CFN, a public but autonomous financial second-floor institution, is currently the major provider of finance for the microenterprise sector. During 1997, this institution disbursed some \$8.3 million for microenterprise-related activities.³² CFN funds for financial intermediation include \$16 million from the IDB (already lent out) and \$50 million from the government's Solidarity Fund. These funds are lent to regulated and qualified financial institutions (banks, credit unions and mutualists) that meet minimum criteria to intermediate these funds.

CFN also supports technical assistance for financial institutions that are interested in becoming involved in microfinance or incrementing their microfinance portfolio. In addition, CFN is trying to develop mechanisms to finance the microenterprise lending activities of NGOs and credit unions that are not under the Superintendency of Banks.³³

In the early 1990s, the GEMINI study concluded that financing of microenterprise involved "a large amount of financial layering for on-lending flows through an institutional maze that involves delays, bureaucracy and high costs before they reach the borrowers" (Magill and Swanson, 1991). The study recommended simplification and streamlining if a large number of enterprises were to be served. Efforts of the CFN, NGOs, specialized MFIs, credit unions and some commercial banks (e.g., those receiving technical assistance from the CFN) are helping to accomplish this streamlining and expand the frontier of microfinance in Ecuador.

B. ANALYSIS OF A SELECTED GROUP OF MFIs

1. Institutional Structure

As previously mentioned, the Ecuador fieldwork conducted by the project team coincided with an unexpected worsening of the financial crisis. The visit was reduced to three working days under severe circumstances for the selected group of institutions. Therefore, the data summarized below provide a general view of the current level of their microfinance activities.

The group of selected institutions constitutes some of the most advanced participants in the developing microfinance market in Ecuador. All the various best practices methodologies are found in this group (Table 4.2). Banco Solidario uses solidarity groups, FINCA and Catholic Relief Services offer village banking and FED and the credit unions operate with an individual loan methodology.

³² CFN, *Memoria 1997*. P. 43.

³³ Currently, only 26 credit unions are under the control of the Superintendency of Banks.

Table 4.2: Ecuador: Advanced MFIs		
Institution Year created	Institutional Structure Lending Methodology (Best Practices)	PVO/CDO Affiliation
Banco Solidario 1996	Commercial Bank. Solidarity group lending methodology. Also provides individual loans. Operates in urban areas.	Affiliated with Accion International and the Micro-finance Network. Banco Solidario resulted from the initiative of a group of individuals who formed Fundacion Alternativa-Enlace Mas in 1991. In 1995, decided to create a regulated financial institution and received financial support from USAID. Subsequent capital investments have been received from Seed Capital, Profund, CAF, Care Ecuador and Accion International.
FED 1968	NGO. Individual loans methodology. Although FED initiated its operations in rural areas, currently operates only in urban areas.	Affiliated with Accion International and the Microfinance Network. Has received support from various international donors; for example, the IDB provided US\$500,000.
FINCA 1994	NGO. Village bank methodology. Urban areas of Quito and Guayaquil.	Affiliated with FINCA International. Program started with the support of the Inter-American Foundation. USAID has provided some US\$600,000.
Catholic Relief Services	NGO. Village bank methodology.	Affiliated with Catholic Relief Services.
Progreso Credit Union 1969	Credit Union: Non-bank financial intermediary. Individual lending methodology. Operates in peri-urban areas. Principal office in Pomasqui, a rural area already forming part of the greater Quito metropolitan area.	Created by a group of 32 members of the rural community Atahualpa, including small business owners, small farmers and teachers. Ownership: 52,632 middle- and low-income shareholders. Currently receiving technical assistance from WOCCU in financial and institutional strengthening, including a microenterprise lending component.
23 de Julio Credit Union 1964	Credit Union: Non-bank financial intermediary. Individual lending methodology. Operates in peri-urban areas with a large participation of rural members, particularly indigenous groups (e.g., Otavalo).	Created by a group of public school teachers in the rural town of Cayambe. Ownership: 40,588 middle- and low-income shareholders. Currently receiving technical assistance from WOCCU in financial and institutional strengthening, including a microenterprise lending component.

These sample MFIs help us to identify some key issues in understanding the current microfinance market in Ecuador:

- The economic and financial sector environment has not been propitious for fostering a dynamic microfinance sector. The financial sector authorities, the Central Bank and the Superintendency of Banks, are still in a process of consolidating the financial sector. These regulatory and supervisory agencies still need to develop their own technical capabilities. This contrasts with the case of Bolivia, where the SBEF has been very supportive of new ways to incorporate new players in the financial system that can provide financial services to low-income groups.
- Among the MFIs, only Banco Solidario and some credit unions are under the Superintendency of Banks. NGOs such as FED that have operated for 30 years have not followed the model of converting into a regulated financial institution, as has been the case of NGOs in Bolivia, which became private financial funds. This limits the ability of specialized MFIs to mobilize deposits and access other sources of local and international funds.
- Ecuadorian MFIs are still in the process of working together to develop microfinance. Banco Solidario is playing a leadership role in supporting other institutions. For example, it provides

wholesale loans to FED. It also has a foundation dedicated to microenterprise-related training for other institutions interested in microfinance. In addition, it has offered to become an institutional home for village banks programs and teach credit unions its solidarity group methodology. This is due, in part, to the bank's social mission. It is also due to the relative lack of competition in the Ecuadorian market.

- Most of the MFIs work in urban areas. Rural areas continue to lack appropriate access to financial services, both credit and savings.
- Small savings services are offered mainly by some of the largest commercial banks. These are banks that are less likely to lend to their own small savers. Banco Solidario has a small savings program related to housing, but has not been able to expand savings services. Other specialized MFIs such as FED are not authorized to mobilize savings. Among the institutions offering services to lower-income groups, the credit unions are the only ones offering both micro savings and loans.

2. Outreach: Credit

a. Scale of Outreach

Table 4.3: Selected MFIs, Scale and Depth of Outreach, Credit as of 12/ 31/ 98 (\$,000)							
MFIs	Number of Clients	Value of Outstanding Loans US\$000	Number of Branch Offices	Average Number of Clients per Branch	Average Outstanding Loan Size	Loan as a % of GDP per Capita US\$1,391(1)	% of Women Clients
B. Solidario	35,675	\$39,867	11	3,243	\$1,118	80%	55%
FED	11,596	\$3,397	22	527	\$293	23%	64%
FINCA	Clients: 4,835	\$285	2 Reg. Offices 208 Village Banks	Average 23 borrowers in village bank	\$59	4%	100%
Catholic Relief Services	Clients: 5,784 Borrowers: 4,314	\$228	168 Village Banks	Average 23 borrowers in village bank	\$53	4%	92%
Progreso CU	Clients: 52,638 Borrowers: 12,314	\$11,634	5	Clients: 10,528 Borrowers 2,463	\$945	68%	43%
23 de Julio	Clients: 40,588 Borrowers: 7,226	\$7,702	4	Clients: 10,147 Borrowers: 1,806	\$1,066	77%	48%
TOTAL	156,900	\$63,114	44	(1) GDP/per capita for 1997. Source: IDB, 1998.			

The group of selected MFIs has a consolidated clientele of some 156,900 and a loan portfolio of \$63 million (Table 4.3). Banco Solidario has the largest outreach of borrowers, with 35,675 at the end of 1998. The Bank's total loan portfolio, however, is comprised of a variety of loans. Those that are strictly microenterprise comprise about 14 percent of the volume of the portfolio.

The credit unions have a total clientele or membership of 52,638 in the case of Progreso, and 40,588 in the case of 23 de Julio Credit Union. In both credit unions, the average number of borrowers is 20 percent of the total membership. When the percentage of Banco Solidario's portfolio going to microenterprise is taken into consideration, Progreso Credit Union has the largest volume of loans of the selected MFIs and 23 de Julio is third at the end of 1998, the two credit unions had some 20,000 borrowers.

b. *Depth of Outreach*

All the selected MFIs have average loan sizes under the average GDP per capita (Table 4.3). The specialized MFIs that are NGOs are reaching deeper than Banco Solidario and the credit unions. The NGOs with village banks have an average loan size of US\$56; FED is a little higher with an average size of US\$293. While the NGOs have a more homogeneous group of borrowers, the bank and the credit unions provide services to microentrepreneurs with a variety of business activities and at different levels of enterprise development. Furthermore, the credit unions provide a variety of loans. For example, the 23 de Julio Credit Union granted loans for agricultural activities averaging US\$1,322 and loans for housing averaging US\$1,654. In Bolivia, the membership of the two credit unions studied was greater than 50 percent. In Ecuador, by contrast, the percentage of female membership ranged from the low to mid 40s.

c. *Quality of Outreach*

"Quality" refers to client satisfaction, the costs imposed on the client and the appropriateness of the contractual terms. Quality results from the characteristics of the loan products offered in the developing microfinance market. These include:

- **Loan purpose:** Low-income borrowers and microentrepreneurs can access loans for any purpose and in a variety of sizes: from working capital loans averaging US\$50, as in the case of FINCA and Catholic Relief Services village banks, to housing loans averaging US\$1,600, as in the case of 23 de Julio Credit Union.
- **Guarantees:** Borrowers can use a variety of guarantees, including personal and group guarantees. In contrast to the experience of BancoSol and PRODEM in Bolivia, in Ecuador the preferred lending methodology is individual loans. Loan terms also are offered in a variety of lengths: from 16-week loan terms in FINCA's village banks to five-year terms in Progreso Credit Union for housing loans. .

- **Interest rates:** Compared to interest rates in other microfinance markets,³⁴ the MFIs have average interest rates that are comparable to those of commercial banks, which average 5.5 percent. Furthermore, the MFI rates are half of those commonly charged by loan sharks (around 10 percent per month charged to informal vendors in downtown Quito).

The large membership of credit unions demonstrates that they are offering financial services to populations not served by traditional banks. For example, in Pomasqui, where Progreso Credit Union has its main office, it was not until 1996 that a bank opened an office. The number of members in Pomasqui was larger than the EAP (a penetration rate of over 100 percent) because members came from surrounding areas of Quito. In the case of 23 de Julio Credit Union, in Cayambe and Otavalo, where the credit union has branches, its large membership of over 40,000 provides evidence that the credit union serves a market niche. The credit unions' membership reflects the composition of the rural and peri-urban communities where they operate, including low-middle- and low-income inhabitants.

2. Outreach: Savings

Among the MFIs studied, only Banco Solidario and the credit unions are authorized to mobilize savings. FED, FINCA and Catholic Relief Services are unsupervised NGOs. FINCA's village banks members save among themselves and as of December 1998 had accumulated \$154,000 in small savings. The average account of the savings passbook in Banco Solidario is US\$613, while at the credit unions the average balance is US\$130.

Table 4.4: Ecuador: Selected MFIs, Scale and Depth of Outreach—Savings as of December 31, 1998 (US\$ 000)								
MFIs	Clients Savers	Number of Branches	Volume of Demand Deposits (Savings Passbooks)	Volume of Fixed-term Deposits	Total Volume	Average Savings Passbook Balance	Savings as a % of GDP per Capita	(US\$1,391 for 1997)
B. Solidario	8,000	11	\$4,906	\$22,852	\$27,759	\$613	32%	NA
Progreso CU	52,638	5	\$6,790	\$625	\$7,316	\$129	7%	45%
25 de Julio CU	40,588	4	\$5,269	-	\$5,269	\$130	7%	48%

A key issue in the mobilization of small savings is that many low-income people deposit their savings in banks that are not interested in them as credit clients. A major challenge for regulated institutions with microfinance services, such as Banco Solidario and credit unions, is to attract those savings. Banco Solidario is using an approach similar to that of BancoSol and the PFFs in Bolivia, which is mobilizing large, fixed-term deposits from institutional investors. This saves on the costs of mobilizing small sum savings, but leaves these institutions vulnerable to large withdrawals. Credit unions are clearly successful in mobilizing small sum savings.

³⁴ For example, BancoSol (Bolivia) charges a rate that almost doubles the average rate of commercial banks.

4. Sustainability: Financial and Operational Performance

a. *Financial Structure*

As of December 1998, the consolidated assets of the MFIs examined totaled \$109.8 million. Banco Solidario had by far the highest total assets at more than \$77 million. Progreso and 23 de Julio Credit Unions' assets ranked second and third respectively among the selected institutions. Between them, they had slightly less than \$25 million.

When it comes to funds borrowed from banks and other financial institutions, the two credit unions only accounted for about four percent of the total. This reflects their emphasis on savings mobilization. The credit unions also have the largest ratio of deposits to total assets, averaging 51 percent, providing evidence that it is possible to mobilize small savings from lower-income groups both with savings and equity instruments. In the case of the credit unions, their combined members' shares amount to US\$10 million. Both FED and FINCA rely on loans and capital increases to finance their operations since they are not authorized to mobilize savings. Consequently, their dependence on commercial sources increases their financial costs.

b. *Financial Performance*

The delinquency rate (over 90 days) of the specialized MFIs (Banco Solidario, FED, FINCA and Catholic Relief Services) is under five percent (Table 4.5). The credit unions show a higher rate—7.6 percent for Progreso and 8.1 percent for 23 de Julio. These delinquency rates are for the total portfolio at risk. A possible reason for the higher delinquency rate is the average number of loans per credit analyst. The credit unions have the highest average of loans per credit analyst. Progreso Credit Union has 425 loans per credit staff. This might be a sign that they are not lending and/or monitoring carefully. Both credit unions, however, have achieved a high operational and financial self-sufficiency.

Given the adverse economic and financial conditions in Ecuador during 1998, this group of institutions has been able to maintain a high level of repayment. However, the return on average equity and total assets was under inflation (45 percent) for all the institutions.

Table 4.5: Ecuador: Selected Group of MFIs, Financial Performance as of December 31, 1998

MFIs	Delinquency over 90 Days	Return on Average Total Assets	Return on Average Equity	Operational and Financial Self-sufficiency	Operational Expenses/Average Assets
B. Solidario	4%	3.1%	15.8%	112%	8.7%
FED	2.8%	22.6%	46%	168%	12.7%
FINCA	4.3%	0.3%	0.39%	101%	41.1%
Catholic Relief Services	4.5%			95%	
Progreso CU	7.6%	12.7%	30.4%	154%	14.8%
23 de Julio CU	8.1%	7.2%	21.6%	136%	14.4%

C. CREDIT UNIONS IN ECUADOR: PARTICIPATION IN MICROFINANCE

1. Strengths

a. *Potential to Expand Outreach*

The cases of the Progreso and 23 de Julio credit unions, together with the group of specialized MFIs (Banco Sol, FED, FINCA and Catholic Relief Services), demonstrate that they participate actively in the expansion of the local microfinance market. Lessons and practices from these two credit unions could also be used to evaluate the current participation in microfinance of a larger number of credit unions that are receiving technical assistance from WOCCU with USAID financing.

Basic statistical and financial information for 19 credit unions that participate in the World Council of Credit Unions technical assistance program shows that they served 672,188 members at the end of 1998. This is a 30 percent increase from their membership in 1996. Assuming that the EAP is 40 percent of the total population of 11.7 million (1996), the penetration rate of these 19 credit unions would be about 14 percent. With financial strengthening, high current rates of growth and low penetration rates, Ecuador's credit unions should continue to grow at a rapid pace.

b. *Regulatory Framework*

In 1995, open credit unions came under the control of the Superintendency of Banks. These were the largest credit unions in the country. The control of the Superintendency of Banks has helped to improve several areas in which credit unions are commonly criticized. Among the changes are improvements in the criteria for board of directors, and the establishment of credit committees comprised of professional staff rather than volunteers. Many observers point to major improvements in the governance of credit unions.

c. *Permanence in the Market*

Ecuador's GEMINI study concluded that credit unions were significantly involved in micro- and small-enterprise financing (Magill and Swanson, 1991, p.25). Among the most relevant factors identified were: 1) credit unions were self-sufficient, with no external subsidies for operating expenses, 2) credit unions operated with internally generated capital, demonstrating that it is possible to fund significant lending volume with internal sources and 3) credit unions did not depend on external loans. Eight years after this analysis (as evidenced by the cases of Progreso and 23 de Julio) credit unions continue to compete in local financial markets, demonstrating the potential for microfinance by providing access to crucial services for microentrepreneurs, businesses and households.

d. *Dissemination of the PERLAS System*

The group of credit unions currently receiving technical assistance from WOCCU is adopting the PERLAS system of performance. This system provides a guide for monitoring financial and operational performance based on protection, financial structure, earnings and costs, liquidity and growth. PERLAS not only helps to create financial discipline but also is a managerial tool to plan for the credit unions' sustainability.

e. *Special Microenterprise Lending*

WOCCU has introduced 11 credit products that are tailored to the needs of microentrepreneurs. Among the new products are "open-end" lines of credit (one-year pre-approved line), restructuring liabilities, letters of credit and interest-free supplier advances. These instruments are for more developed microentrepreneurs. Many of these products are offered in the market by commercial banks but are not accessible to lower-income entrepreneurs.

2. Limitations

a. *Loan Delinquency*

When compared to other MFIs, the two credit unions studied have higher rates of loan delinquency. The credit unions disbursed a larger number of loans per credit staff person. The lower amount of time spent on loan analysis and monitoring might be affecting the loan repayment culture that successful MFIs have been able to disseminate. There is a great need for credit unions to learn more from other MFIs in this area. The credit unions under WOCCU Technical Assistance have been able to reduce delinquency rates to an average of 10 percent, demonstrating that it is possible to minimize delinquency in credit unions with adequate mechanisms.

b. *Small vs. Large Credit Unions*

Credit unions not only in Ecuador but also in other Latin American countries are facing the reality of competing in the market with MFIs. They are confronted with the reality of achieving economies of scale that allow them to reduce costs and increase profitability. Larger credit unions are opening branches close to smaller credit unions. This might look beneficial in terms of providing more competitive services. However, credit unions need a sectoral strategy as institutions with the common goal of serving those outside traditional banks. They need to work more as a system or network than as isolated entities. Their challenge is to provide competitive services to a low-income population without access to financial services. This will probably require liquidations, mergers and acquisitions.

c. *Limited Participation with Other Institutions Working in Microenterprise Development*

Credit unions are not active participants in local activities sponsored by institutions working in microenterprise development. They need to contribute to these debates. Banco Solidario is offering a good example by being willing to share experience and know-how with other

microfinance providers. As a Banco Solidario staff person stated, the challenge is to work with others to expand financial services to microentrepreneurs in addition to working on their own institution's issues.

D. LESSONS, PRACTICES, AREAS OF LINKAGES AMONG MFIs AND KEY ISSUES IN MICROFINANCE IN ECUADOR

- **Small savings mobilization:** The ability of credit unions to mobilize savings at competitive rates and low cost is a lesson for other MFIs.
- **Learning non-traditional lending mechanisms:** Credit unions in Ecuador, such as 23 de Julio, expressed interest in learning about solidarity groups. Credit unions in Bolivia are already implementing the solidarity group methodology. Therefore, it would be useful to provide opportunities for credit unions to learn from each other as well as from other MFIs. In Bolivia, solidarity groups have proven useful to low-income microentrepreneurs in finding co-signers who are willing to be guarantors. Credit union members have expressed their concern about the difficulties of finding regular co-signers. The solidarity group can complement the individual loan methodology that is used by credit unions.

CHAPTER V: BURKINA FASO

A. RESEAU DES CAISSES POPULAIRES DU BURKINA (RCPB)³⁵

Burkina Faso is a poor landlocked West African country with a population of 11 million people, 83 percent of whom live in the rural areas. Population growth averaged 2.8 percent per annum (between 1990 and 1997), and the per capita income in 1997 was \$230 per year, making Burkina Faso poor, even by African standards. Seventy one percent of the men and 91 percent of the women were illiterate in 1995.

The *Reseau des Caisses Populaires du Burkina* (RCPB), a Federation of Caisses Populaires or credit unions, was established in 1972 as a response to the severe problems of rural poverty in the country. Assistance was received from Developpment International Desjardins (DID), a CDO that will soon phase out its last resident advisor to RCPB. Financing was provided by the Canadian International Development Agency (CIDA).

Reflecting RCPB's initial heavily social approach of dealing with the problems of rural poverty, it took 15 years for the first credit union to break even. Once RCPB adopted a more business-oriented approach, and expanded its services into the urban areas, the pace of growth accelerated sharply, and it currently takes two to three years for a credit union to break even. It took RCPB ten years to grow from seven credit unions with 2,800 members in 1975, to 11 credit unions with 11,700 members in 1985. During those first ten years savings increased from CFA 35,000,000 to CFA 265,000,000, and outstanding loans from CFA 18,000,000 to CFA 250,000,000.

Ten years later, in 1995, RCPB had grown to 32 credit unions with 58,000 members with CFA 2.8 billion in savings, and CFA 1.6 billion in loans. As of December 1998, there were 62 credit unions and 147,000 members with nine billion CFAs in savings and 5.4 billion CFAs in outstanding loans. By March 1999, three more credit unions had been established, and ten more were in the process of formation.

Between 1993 and 1998, the number of RCPB credit unions grew by a multiple of three, the number of members grew by a multiple of six, the loan volume grew by a multiple of eleven and the volume of outstanding loans grew by a multiple of 22. In 1998, revenues exceeded costs by a factor of two, and 73 percent of the credit unions were profitable, even though many were only recently established. About half of the loans are for productive purposes, the rest are for consumption and housing. In short, RCPB was a highly dynamic organization with financially strong, rapidly growing members.

³⁵ The study of RCPB in Burkina Faso was carried out between March 29 and April 2 1999, by Jeffrey Ashe of the study team and Peggy Roark of Freedom from Hunger. The General Director and the Director of the Credit with Education program, who accompanied the team on most of the interviews, were interviewed extensively. Visits were made to three credit unions, two credit associations, three regional offices, and the director of the inspection team. The Administrative council at one credit union was also interviewed, as were Credit with Education animatrices, CU managers, cashiers, and credit association members.

Table 5.1 Growth of Réseau des Caisses Populaires du Burkina 1993 to 1998						
	12/1993	12/1994	12/1995	12/1996	12/1997	12/1998
Credit Unions	19	25	32	46	48	62
Members	25,543	37,211	57,724	92,656	126,613	146,781
Savings (CFA 000)	759,710	1,787,479	2,838,873	4,687,201	6,529,296	8,766,459
Loans (CFA 000)	253,742	539,590	1,586,708	3,145,839	5,400,306	5,472,124

This period of rapid growth reflects a strategy of going to the urban areas where the savings are, as it is urban savings that fuels rural economic development. While there are considerably more rural credit unions, there are three times as many RCPB members in the cities as in the rural areas. Of the 311,000 members projected for the year 2003, 241,000 will live in cities. It is their savings that will fuel enterprise development in the rural areas.

The recently completed RCPB strategic plan projects that the rapid growth of the last several years will continue. Since RCPB estimates that it is only serving 22 percent of its potential market, calculated at one member for half of the families in the country, the possibility for expansion is vast.

Table 5.2 Projections (1999 TO 2003)					
	12/1999	12/2000	12/2001	12/2002	12/2003
Credit Unions	80	92	100	110	119
Members	166,750	200,316	238,067	273,107	310,812
Savings (CFA 000)	10,169,250	12,966,220	16,259,064	19,515,477	23,104,956
Loans (CFA 000)	7,039,043	8,097,065	10,228,496	12,521,086	14,917,162

RCPB is already the dominant force in microfinance in Burkina Faso, and will likely become an even stronger force in the future. RCPB is little concerned about the potential competition, especially since, as a federation of credit unions, it can offer savings as well as loans. In 1997 alone, RCPB represented 62 percent of the members, 77 percent of the savings and 55 percent of the outstanding loans of all the microlending programs in the country.

Table 5.3						
Number of Microcredit Institutions	All members	RCPB members	All savings	RCPB savings	All loans	RCPB loans
1993 11 institutions	N.A.	26,000	2.8 billion	760 million	1.3 billion	254 million
1995 23 institutions	158,000	93,000	5.0 billion	2.8 billion	4.2 billion	2.0 billion
1997 30 institutions	227,000	120,000	8.4 billion	6.4 billion	12 billion	5.6 billion

Even though RCPB was performing admirably, compared to other organizations in the local microfinance field, it still felt it was not meeting its mission of alleviating poverty, especially in the rural areas. Reflecting this concern RCPB, adopted Credit with Education, a model being offered by Freedom from Hunger, to allow it to extend credit unions from the towns into villages, and from comparatively better off urban residents to poor women. With Credit with Education, instead of the client coming to the credit union, the credit union comes to a group of women meeting under a tree in the village.

B. THE RCPB/CREDIT WITH EDUCATION HYBRID

The RCPB/Credit with Education hybrid that emerged in Burkina Faso will be explored in some depth, since it provides a model approach for extending microfinance lending to poor women who live in the villages. It is especially relevant for this study as an example of a credit union that has adopted a microfinance strategy. Extending credit to the poor and to villages through Credit with Education adds to the credit union's already extensive lending for economic activities. About half of all RCPB's loan activities are for economic purposes, but generally at a higher level than that given by the credit associations.

Credit with Education has been developed and perfected over the last decade by Freedom from Hunger, a PVO based in Davis California. The model combines village banking with an innovative health and nutrition and business education package that is an integral part of the credit delivery package. As of December 1998, Freedom from Hunger was reaching 105,604 poor women in seven countries through its Credit with Education program. Seventy thousand of these poor women are being served through the credit union federations in West Africa, and the Philippines.

Based on its success in West Africa and its new relationship with WOCCU, FFH expects that its work with credit unions will expand much more quickly than its direct service initiatives in Bolivia and Uganda, and its work with rural banks in Ghana. RCPB was Freedom from Hunger's first credit union partnership, and with 30,000 active customers, its largest effort to deliver Credit with Education through a credit union federation.

Credit with Education is a unique model. Instead of credit unions recruiting individual villagers to join the credit union, which would be difficult since the distances are great and most villagers are too poor to pay fees or collateralize their loans with significant savings, twenty to thirty poor women join together as a single credit association. The savings and loan payments from the entire group are entered as a single transaction, which greatly simplifies bookkeeping.³⁶ The credit associations help fulfill the credit union's social mission of serving the community, as they generate a stream of income for the credit unions through interest payments on previously unutilized savings.

³⁶ John Hatch, the developer of the village banking methodology and founder of FINCA, sees village banks as pre-cooperatives, and was inspired by the fundamental cooperative principles of meeting community needs for savings and credit services and local control.

Currently 49 of the 65 RCPB credit unions have Credit with Education credit associations. The RCPB Managing Director estimates that a single credit union can manage up to 45 associations (the average is 25), with approximately 900 members. As of December 1998, 1,219 associations were providing credit and education services to poor women. If all those who had dropped out over the previous five years (most come back in a cycle or so) were included, close to 60,000 poor rural women have been members of credit associations at one time or another. The women use their loans for their businesses that include buying and selling agricultural produce, and preparing cooked food and condiments to sell in the market.

Table 5.4 Credit with Education Outreach (1993 to 1998)						
	12/1993	12/1994	12/1995	12/1996	12/1997	12/1998
Animatrices	NA	NA	NA	NA	36	98
VB per animatrice	NA	NA	NA	NA	24	12
Borrowers per VB	22	20	24	22	25	22
Memb. / animatrice	NA	NA	NA	NA	631	306
Village Banks	38	158	263	470	876	1,219
Members	1,204	4,445	8,311	14,944	22,721	29,998
Borrowers	854	3,228	7,050	11,726	22,321	27,214
Average loan	\$22	\$20	\$48	\$79	\$48	\$52
Outstanding Loans	\$19,172	\$65,714	\$341,110	\$933,929	\$1,073,608	\$1,469,932
Savings	NA	NA	\$44,017	\$75,064	\$156,352	\$74,371

The RCPB strategic plan projects 2,430 associations with 60,750 members and CFA 2,511,725,000 (approximately \$4,000,000) in outstanding loans by 2003. If there are insufficient savings to meet the demand for loans, RCPB will go to the commercial banks for credit. The fact that RCPB has included Credit with Education as a detailed part of its five year plan reflects RCPB's commitment to the this special village level initiative.

Table 5.5 Credit with Education Strategic Plan Projections (1999 to 2003)					
	12/1999	12/2000	12/2001	12/2002	12/2003
Animatrices	118	134	142	153	162
Village Banks	1,770	2,010	2,130	2,295	2,430
Members	44,250	50,250	53,250	57,375	60,750
Outstanding Loans (000)	1,012,500	1,378,800	1,670,490	2,062,703	2,511,725

In a similar way, the credit unions in Bolivia showed they could serve urban market vendors through solidarity groups, thereby effectively extending the credit union to that market. What RCPB accomplished by adding Credit with Education to reach poor villagers, however, is much more difficult than what the cooperatives accomplished in Bolivia:

- Those served through Credit with Education are much poorer than the market vendors and are illiterate;
- The distance the field staff travel to reach their customers is much greater;
- The ratio of members to credit agents is higher;
- The contact with the clients is less frequent, and;
- The credit association members take a much larger role in managing the group.

In addition, the field staff provides basic nutrition and health education to members, along with forming, training and supporting the actual credit associations, and does much of the basic record keeping, since most all members are illiterate.

In seeking an effective credit mechanism to serve the rural poor, one of the major advantages of the credit union/credit association hybrid is that it avoids the problems of poor management that are endemic with the small independent credit unions and NGO projects. Quality services are assured in well over 1,000 villages in Burkina Faso, because Credit with Education credit associations are fully integrated into the supervision, training, record keeping and inspection services of the credit union federation.

Based on the success of the RCPB/Credit with Education initiative, FFH has replicated the model:

- In two credit union federations in Mali in 1996. By December 1998, the Mali initiative had grown to 1,161 credit associations with 23,000 members. As in Burkina Faso the members of the credit associations in Mali are poor, illiterate women who live in the villages surrounding the established credit unions. Nyesigiso has 45 credit unions with 35,000 members, and Kafo Jiginew has 76 credit unions with 46,000 members.
- In Togo where Credit with Education operates through the local credit union federation, FUSEC, Credit with Education had grown to 238 credit associations with 5,965 members by the end of 1998. The Togo initiative started in 1996.
- In the Philippines, Credit with Education is being carried out through Credit Union Empowerment and Strengthening (CUES). This is the Technical Assistance Unit that's been set up by WOCCU with IGP funds to work with individual credit unions. The program in the Philippines was started in August 1998. By March 1999 there were already 3000 credit association members in 4 credit unions.

Training is also underway for future credit union/Credit with Education's partnerships in Benin and Madagascar.

What has emerged through Credit with Education's experiences with various credit union federations is a highly replicable methodology that, given a solid financial institution to work through, and a large untapped market, can serve significant numbers of very poor women villagers within a few years. At the same time, the Credit with Education credit associations program can cover their operating costs and even generate a surplus for the local credit union within three to five years.

These impressive results are a testimony to both *Developpment International Desjardins* (DID) in Burkina Faso and Mali, and the World Council of Credit Unions (WOCCU) in Togo and the Philippines. DID and WOCCU built the credit union movements in these countries, and then strengthened them to the point where they are not only growing rapidly and profitably, they are expanding their outreach to the villages by using the Credit with Education methodology. The positive results are also a testimony to Freedom from Hunger that has worked for a decade to perfect and then launch the Credit with Education model. The institutional strengthening of both WOCCU and Freedom from Hunger was financed through the PVC grant programs.

The analysis of the RCPB/FFH partnership in Burkina Faso that follows can serve as a guide for the implementation of similar initiatives in other countries. In addition to a credit union, or credit union federation, a commercial bank, or a specialized microenterprise bank, or even an NGO, can use these principles to extend services to villages cost effectively. In this regard, FFH has also replicated the same Credit with Education package in six of Ghana's Rural Banks, where it is reaching approximately 11,000 clients.

What is required for as a successful platform for a Credit with Education initiative is a financial institution that:

- Provides savings and credit services,
- Has a high level of commitment to extend services to villages,
- Has an appreciation for the skills and organizational capacity that it takes to deliver these services in poor villages.

What Freedom from Hunger offers its partners is a well-defined methodology, a clear set of manuals and systems, and a well formulated plan and training package for transferring this technology.

What follows is an analysis of the factors that have led to the successful implementation of the Credit with Education within RCPB. Each of the factors listed in the chart below has proved important to the success of the initiative, and should be considered by any institution seeking to replicate the model.

An institution seeking to provide credit and savings services to villages needs to:

Provide an accessible, useful, reasonably priced, growing and reliable source of credit that:

- 1) Is used to build off-farm, and subsistence farming activities at the smallest level.
- 2) Reaches very poor, often illiterate villagers living close to towns and in more distant rural areas.
- 3) Reaches this population in large and rapidly growing numbers.

Delivery:

- 4) Uses a very efficient system for service delivery and that achieves an exceptionally high rate of loan repayment.
- 5) Can be quickly taught to field staff who use well-conceived, simple and well-documented procedures that are standardized throughout the program.
- 6) Builds local leadership and creates new institutions at the village level.
- 7) Serves as a platform for imparting business skills and, in this case health and nutrition information, in a way that does not add to the costs of providing credit services alone.

Impact:

- 8) Promotes a change in relationships between men and women that encourages equality, and investment in children.
- 9) Provides access to a wider range of services to those ready to graduate from the limited credit and education services provided at the village level.

In order for the hybrid to be successful, at the level of the financial institution the village initiative should:

- 1) Increase the profitability of the financial institution housing the project.
- 2) Fully integrate village level lending into standard savings and credit activities at the branch office level in the towns.
- 3) Incorporate the leadership of the organizations created at the village level into its structure of governance at the branch level.
- 4) Decentralize decision-making for loans and accountability for their repayment to the villages.
- 5) Have a liquidity facility in place that can move savings from urban areas where savings exceed loan demand, to rural areas where loan demand exceeds saving.
- 6) Serve a sufficiently wide range of customers in towns and cities, so that temporary setbacks in performance at the village level caused by drought and other natural disasters, can be absorbed by the entire institution.
- 7) Be rigorously audited to prevent fraud.
- 8) Be managed by committed, energetic, highly capable leadership from within the country.
- 9) Have a clear sense of mission that balances profitability with serving the poor.
- 10) Have a detailed strategic plan that projects its performance over several years, and that specifies the actions needed to achieve performance objectives.
- 11) Serve as a source of inspiration and technical advice for similar initiatives in other countries.

The importance of each of these factors at the level of the village credit association is indicated in the tables below:

<i>VILLAGE LEVEL</i>	<i>KEY DIMENSIONS</i>	<i>RCPB/Credit with Education EXPERIENCE</i>
<i>1) Provide an accessible, useful, reasonably priced, growing and reliable source of credit.</i>	Credit services should be delivered directly to the village and not require travel to town for transactions, and costs must be competitive with other locally available credit options. The village should be large enough to reach fifty to one hundred women, of whom twenty to thirty will be active participants at any one time.	Credit with Education loans are much more accessible to the poor than CU loans. RCPB loans require 25% of the loan amount in savings as a guarantee and 100% collateral. Credit with Education loans do not require collateral and require only token savings. Credit with Education loans are given the highest priority by RCPB, and are issued first, even though other borrowers must wait, indicating the high priority that RCPB gives to Credit with Education.
<i>2) That is used to build off-farm, and subsistence farming activities at the smallest level.</i>	The loan package must make sense both for the level of businesses reached, <i>and</i> the level of risk the program can assume.	The loans, that average \$57, are used by the women for economic activities, such as buying and selling agricultural produce, and selling prepared foods and condiments. The typical business consists of a container of grain, and a few stacks of onions, or a small pail of condiments to be sold in the market.
<i>3) That reaches very poor largely, illiterate villagers living in rural villages up to an hour from a town.</i>	Formal requirements – collateral, cosigners, and land titles, forms to fill out and literacy – would select out most potential customers. Guarantees based on mutual accountability, with strong consequences for non-compliance, take the place of formal requirements.	Credit with Education brings credit and education services to villages as far as 35 kilometers from a credit union office (although most credit associations are much closer). Instead of the villagers coming to the credit union office, the credit union is brought to the village and services are delivered to a group of women under a tree.
<i>4) That reaches this population in large and growing numbers.</i>	Only a large-scale program justifies the level of effort and expense required to start a major new initiative that will begin to meet the enormous demand for services in rural areas.	Credit with Education, that ended its first year of operations in 1993 with 38 credit associations with 1,204 members and \$19,172 in outstanding loans, had, by the end of 1996, grown twelve times to 470 credit associations with 14,944 members and \$933,929 in outstanding loans. By the end of 1998, Credit with Education doubled again to 1,219 credit associations with 29,998 members and \$1,469,932 in outstanding loans.

VILLAGE LEVEL	KEY DIMENSIONS	RCPB/Credit with Education EXPERIENCE
5) That uses a system for service delivery that generates a surplus, and achieves an exceptionally high rate of loan repayment.	An institution is unlikely to take on a major new initiative, however well it might help it meet its social goals, if it will not generate a surplus of income over expenses in a few years. Since loan default is a major cost, maintaining almost perfect repayment must be one of the highest priorities.	Services are provided through a network of 98 animatrices who work through 49 of the 75 RCPB credit unions. Each animatrice is responsible, on average, for 12 credit associations with 306 members, and manages a portfolio averaging \$15,000, which generates enough interest income to pay the \$2,000 it costs to field an agent. As the program builds experienced animatrices should serve close to twenty villages.
6) That can be quickly taught to field staff who use well conceived, simple, and well documented systems	The importance of a standardized system of service delivery that can be quickly taught to field staff and that is carried out consistently throughout the system, insures high quality, comparable monitoring, clear accountability, and the rapid dissemination of learning throughout the system.	Credit with Education provides a comprehensive set of manuals and systems and complete training and ongoing technical support in their use. Except for the savings and loan transaction records, the entire structure, including loan approval, and education, is built on the assumption that members are illiterate
7) That builds local leadership and creates new institutions at the village level.	Credit associations that require the group to recruit and select its members, elect officers and hold each other accountable for loan repayment tend to develop local leadership.	While from the credit union's perspective a strong local organization reduces operating costs, because the villagers do so much of the work, what results is that Credit with Education builds a new institution for rural women.
8) That serves as a platform for imparting business skills and other information in a way so that what is learned is readily applied.	Delivering education services and credit should not be appreciably more costly than providing credit services alone. For this reason training must be carried out by the credit staff during regularly scheduled meetings. Hiring a separate training staff would be too expensive.	Considerable attention must be paid to the content of the curriculum and how the lessons are delivered. Well-conceived lessons with role-playing and discussion how new information works best. One of FFH's contributions was to develop this curriculum for health, nutrition and business, and to develop a way to train local field staff in its use.
9) That promotes an evolutionary change in relationships between men and women that encourages equality, and investment in children.	Additional income from the business within the supportive structure of the group tends to equalize relation between men and women. When loans are to women, income tends to be invested first in improved nutrition, then housing, education and health care.	Association members interviewed during the study said they had to be careful to listen to their husbands and not consider themselves better than other villagers, but it required an effort. The women Credit with Education credit association members in Mali are reportedly more outspoken.

The credit association must be placed within an established savings and credit institution. These are the factors that will tend to insure that the village initiative is fully integrated into the institution, aggressively promoted and competently managed.

<u>IMPLEMENTING INSTITUTION</u>	<u>WHY IMPORTANT</u>	<u>RCPB/Credit with Education Experience</u>
<i>1) Increase the profitability of the institution housing the project.</i>	No special initiative, however socially important, will be promoted aggressively and carried out at scale if it represents a long-term drain on scarce resources. One of the major sources of income for the credit unions is absorbing excess liquidity. While there are \$1,500,000 in outstanding association loans, there is less than \$100,000 in savings.	Credit with Education system wide covers all operational and financial costs and it generates a surplus in established sites. There had been no long-term loan losses, as of the end of 1998. While the interest charged on the credit union loans is 10%, Credit with Education borrowers are charged 20% per annum for two 6 month loans and 30% per annum for three four month loans. Almost perfect repayment also makes these loans more profitable.
<i>2) Fully integrate village level lending into standard savings and credit activities at the branch office level.</i>	The more that a new activity, such as Credit with Education is seen as an integral part of branch operations and the local board and staff see the success of the initiative as part of their success, the more likely that it will be carried out carefully and at scale.	RCPB animatrices report to the local CU manager, but are also supervised by a regional Credit with Education coordinator, and are trained by the Federation. This helps insure that Credit with Education is not seen as a Federation initiative.
<i>3) Incorporate the leadership of the associations into the CU governance.</i>	Incorporating the leaders of the credit association into the administrative council tends to further solidify the branch's commitment to its village level operations.	Two members of the local RCPB Administrative Council were credit association presidents in one of the credit unions visited during the study.
<i>4) Decentralize the decision-making authority for loans and accountability for their repayment to the villages.</i>	It is vital that the authority for approving loans at the village level occurs within the village organizations. Approval of individual loans at the branch level would be hopelessly time consuming and undercut a major function of the village organization.	From the perspective of RCPB each credit association is seen as a single savings account, and a single loan. The credit association keeps individual records.

<u>IMPLEMENTING INSTITUTION</u>	<u>WHY IMPORTANT</u>	<u>REPB/Credit with Education Experience</u>
5) Have a liquidity facility in place that can move savings to where loan demand is.	Urban savings greatly exceed urban loan demand; rural loan demand greatly exceeds rural savings. A central liquidity facility insures that savings are invested where the demand is.	RCPB credit unions earn 4% per annum for the savings placed in the central liquidity facility. They earn 10% with their own loans and 20% or 30% for credit association loans. It is more profitable to loan.
6) Serve a sufficiently wide range of customers in towns and cities, so that temporary setbacks in performance in the villages can be absorbed by the entire institution.	Making loans in poor rural areas, especially those subject to draught and flooding is risky. If the implementing institution also includes urban areas and salaried workers as customers whose source of income tends to be more reliable, the more stable income to the institution from these sources will tend to cushion the losses in the villages.	The payment problems in the rural areas caused by last year's draught in Burkina Faso were easily absorbed by the stable level loan repayment in the urban areas.
7) Be rigorously audited to prevent fraud.	When dealing with large sums of money, fraud is inevitable. Rigorous inspection with unannounced audits of the branches makes fraud risky. The inspectors should be audited by an external source.	The Federation inspectors make surprise audits of every CU. Inspections are also carried out at the regional level, and by the Control Committee of the CU. There is less fraud now than when RCPB was many times smaller.
8) Be managed by committed, energetic, capable local leadership.	Ultimately the success of any venture depends on the quality of its leaders.	Although RCPB received technical assistance from DID and later FFH, and RCPB performance statistics are reported to these agencies, all of RCPB's staff are local.
9) Have a clear sense of mission that balances profitability with serving the poor.	An institution may have many resources, but if the leadership does not have a burning desire to serve the poor and the villages, it is unlikely that it will have the energy and commitment required to do so.	There is no question of the professional quality of the RCPB leadership and their passion for quality management and expansion that carries out RCPB's social mission from the cities to rural towns and out into the villages.
10) Have a detailed strategic plan that projects its performance over several years.	A successful institution cannot only be looking at its performance today, it must look ahead to see what is required to meet its objectives in the future.	The strategic plan adopted by RCPB indicates that these numbers will double again within five years. At the same time RCPB will have increased its membership from 147,000 members to 311,000, and from 75 to 119 credit unions.
11) Serve as advisors for similar initiatives in other countries.	The international CDOs/NGOs should use the key staff they helped develop to disseminate this learning elsewhere.	RCPB staff has hosted visitors from much of the rest of Africa and has provided consulting assistance to other African countries.

CHAPTER VI: CONCLUSIONS

A. BUILDING A SECTOR

As Christen, Rhyne and Vogel (1995) point out “the ultimate aim [of microfinance] is clear—many well-functioning institutions in competition serving the entire spectrum of the population.” To accomplish that aim, it is necessary to develop an entire sector. Lessons from Bolivia’s success may be applicable in other situations. The rapid diffusion of financial services to the informal sector in Bolivia, and the likely continuation and strengthening of that process, was due to the fortuitous meshing of these factors:

1. A very large informal sector with a strong market for its goods and services that can make good use of the financial services provided.
2. A reasonable level of economic and political stability and a low inflation rate.
3. The initial willingness of the government to permit considerable innovation and activity in the microfinance arena without hindrance, and a willingness at a later stage to take an active role, when institutions evolved to the point where they needed regulation to mobilize savings and access commercial credit.
4. The vision and commitment of USAID and other donors that for over a decade encouraged the growth of a range of non-profit and commercial institutions capable of reaching the informal sector profitably and at scale. This support helped shape the process of institution building through funding, advice and intervention at the governmental and institutional levels.
5. The committed and capable local leadership of non-traditional credit providers and their often high-profile Boards that advocated for the movement and thereby created a favorable climate for the rapid expansion of the field.
6. The effective use of technical assistance providers with a long-term commitment to the non-traditional financial institutions they helped build in Bolivia. Technical assistance was often provided through PVOs and CDOs that saw the institutions they helped create as part of their networks. These included WOCCU and the credit unions, ACCION and PRODEM, Banco Sol, FFH and CRECER, IPC and Caja los Andes.
7. The effective transfer of tested “best practices” by the TA providers in the areas of methodology, standards, delivery and management was sufficiently profitable to justify building the broad network of agencies now serving the informal sector on a mass scale.
8. A regulatory structure that reinforced the improvement and rapid expansion of financial services to previously under-served markets through competition, without imposing restrictions that would make serving the sector unprofitable. Regulated institutions were

those that wanted to operate at a commercial scale, not experimental start-ups that needed the flexibility to experiment.

9. A virtual saturation of the market has meant intense competition among financial intermediaries, thus leading to new product development and service extension to new markets.

These factors created a climate that led to the rapid growth of a variety of financial institutions, including cooperatives, NGOs, FFPs and banks, that now compete head on to serve a rapidly growing number of informal sector businesses. Responding to competitive pressure as the demand in the easiest to serve urban markets became saturated, some of these institutions are now extending their services to poorer and more rural customers and developing individual loan products to meet the evolving needs of their best customers.

By building the institutional capacity to serve the informal sector, maximum development impact has been wrung out of a minimum investment. These institutions not only cover their operating costs, they generate a profit that can be invested in further expansion.

Understanding how these nine factors have played out in the Bolivian context will help:

- Insure that the process to serve the informal sector that is well underway in Bolivia will spiral outwards to serve poorer informal sector entrepreneurs in more remote areas and not lose its direction and momentum.
- Target where short-term subsidies might be needed to push the frontiers of service delivery that might be ignored by institutions seeking to maximize their profitability.

As donors and practitioners work to build institutional capacity to serve the informal sector in other countries, understanding why and how these nine factors worked together to reinforce the expansion of services to the informal sector in Bolivia may provide a useful framework. What occurred somewhat by chance in Bolivia can be translated into a set of interlocking initiatives, or “Best Strategies” which should, like “Best Practices” at the institutional level, greatly increase the likelihood of a successful outcome.

Assuming a large informal sector in a country and a reasonable level of political and economic stability, and at least the indifference of government in the earliest stages a “Best Strategies” approach must include these elements:

1. The long term focused commitment of USAID and other donors to encourage, finance and shape the development of institutions that can serve the sector on a mass scale profitably, and eventually commercially.
2. The cultivation of committed and capable local leaders who serve as advocates for the process and can intervene at the highest levels if its integrity is threatened.
3. The financing of long-term, quality technical assistance that is used to build the capacity of emerging institutions that can serve the sector at scale and profitably.
4. The insistence on the use of “best practices methodologies” to insure that resources are used efficiently.
5. The creation of an appropriate regulatory structure that protects the consumer while not hindering the growth of large scale, profitable institutions, or imposing an excessive regulatory straightjacket on small-scale experimental projects.

In nations that are too unstable, or where government is hostile to the informal sector, efforts should focus initially on the start-up and expansion of best practice PVO/NGO projects. Only when conditions are more favorable, should the focus be on the very large scale, commercially oriented process that has emerged in Bolivia.

The contribution that the PVO/NGO and cooperative credit providers have demonstrated over the last decades is that it is possible to extend services efficiently, sustainably, and even profitably to a strata of the population that has never been considered as candidates for commercial loans.

The nine elements are outlined in detail in the table on the following pages:

FINANCIAL SERVICE INSTITUTIONS FOR THE INFORMAL SECTOR

KEY FACTOR	WHY IMPORTANT	CONSEQUENCES IF NOT PRESENT
1. UNDERSERVED INFORMAL SECTOR	A largely unserved informal sector, whose activities are profitable enough to pay high interest, can represent a formidable growth and profit opportunity for credit providers, if conditions are right.	There must be enough economic activity in the informal sector to justify extending loans profitably. The most impoverished rural areas require the greatest inventiveness to serve effectively. If the a market is saturated with other credit providers there are few opportunities for new entrants.
2. ECONOMIC AND POLITICAL STABILITY	Political stability, improving economic conditions and low inflation rate represent a good investment climate for both non-profit and commercial micro-finance institutions.	Under conditions of extreme economic contraction, hyperinflation, political instability and open warfare there little or no incentive to extend credit services, or for micro-entrepreneurs to expand their activities.
3. APPROPRIATE ROLE OF GOVERNMENT	Initially the government should take a hands off approach as non-traditional financial institutions are feeling their way. Only when institutions grow substantially in size and demonstrate profitability should the government intervene to regulate financial services to the sector.	Governments that are hostile to the informal sector or that impose a regulatory structure that dampens creativity, or limits profits, or that succumb to pressures to forgive debts, etc., can significantly undermine the development of services to the informal sector on a large and profitable scale.
4. VISION OF DONORS	Donors who have a clear idea of what they hope to achieve and the importance of each of these components will tend to encourage an integrated and self-reinforcing process of expansion of services to the sector. Building this process requires a decades long commitment.	Donors who finance scattered initiatives, or who are ideologically opposed to developing profitable institutions, or who want to protect inefficient practitioners from competition, or who view micro-finance as subsidized poverty alleviation, will not contribute much to moving the process along.
5. COMMITMENT OF INTERESTED PARTIES WITH POLITICAL CLOUT	The dialogue between the Board members, and Directors of the major non-traditional financial institutions, many of who have political clout, and the government can help keep the process on track.	If leadership at the national level is indifferent or hostile the often foreign credit providing institutions will be the only spokespersons for the expansion of services, greatly increasing the chance that the process will be undermined.

KEY FACTOR	WHY IMPORTANT	CONSEQUENCES IF NOT PRESENT
6. APPROPRIATE TA FOR NON-BANK FINANCIAL INTERMEDIARIES	While PRODEM, BancoSol, CRECER, Caja los Andes benefited from intense training and long term ongoing support from ACCION, Calmeadow, Freedom from Hunger and IPC respectively, the credit union movement benefited from assistance from WOCCU to upgrade their systems, serve the informal sector, and meet regulatory requirements.	With all that has been learned about the efficient delivery of credit services over the last two decades it is unlikely that a local institution could invent an effective and profitable approach and develop the appropriate systems within a reasonable amount of time and at a reasonable cost. Short-term technical assistance often does not build much institutional capacity.
7. TESTED PROFITABLE METHODOLOGIES	PRODEM and then BancoSol proved that serving this sector through solidarity groups could be very profitable. This technology has been adopted by the cooperatives. ProMujer and CRECER's village banking initiatives are close to breakeven. FIE, Caja los Andes, and AGOCAPITAL have demonstrated the profitability of individual loans.	The lack of potentially profitably methodologies and/or NGO interventions that are high cost and/or inefficient do not represent a model for other financial institutions that can help develop the appropriate climate for the entrance of credit providers concerned with profit.
8. CONSTRUCTIVE REGULATORY CLIMATE	Now that institutions are serving the sector on a large and growing scale, a strong, independent financial regulatory agency that lays out the "rules of the game," demands reporting, fosters competition and does not set ceilings on interest rates encourages investment and innovation is appropriate.	An unregulated or poorly regulated financial sector is an invitation to corruption and inefficiency. Interest rate ceilings and other regulations make it unprofitable to serve the sector. Meddling by a regulatory agency when institutions are just feeling their way is counterproductive.
9. INTENSE COMPETITION AMONG FINANCIAL INTERMEDIARIES	The dissemination of the solidarity group, individual lending and to a much less degree village banking methodologies, to all credit providers, including cooperatives, has led to the virtual saturation of informal sector markets in urban areas. At the same time larger loans are being provided to the graduates and services are pushing out into rural areas.	When there is no competition, and no standards for performance, there is little or no incentive for credit providers to extend their services to new markets, or develop new products, except as they may be ideologically inclined to do so. PVO/NGOs and the credit unions (at their best) are good examples.

The effort put into increasing financial services to the informal sector in Bolivia reflects a set of assumptions about the direction development should take. By strengthening the very small enterprises and farms that make up most of the economy it is implicitly assumed that these enterprises will be more capable of serving the growing and diversified needs of the local market, and growing export market. Since MFIs focus on providing access to credit to the smallest business of marginalized populations, what results is inherently inclusive and egalitarian. It is only a small step to assume that the entrepreneur's stake and participation in democratic institutions will follow, increasing the likelihood of political stability. Instead of economic power concentrated in the hands of the elite, economic and political power is being diffused to thousands of now more prosperous microbusiness owners and small farmers.

B. CREDIT UNIONS

In chapter 2, comparisons were made between credit unions and other MFIs, from the perspective of those interviewed for the study. There were many different opinions expressed. One purpose of the fieldwork therefore was to resolve these discrepancies. Yet the fieldwork that examined credit union practice relevant to microfinance pointed to the need to recognize that there is no such thing as an average model or most common credit union. There are large credit unions and smaller ones, urban and rural ones, rapidly growing ones and those that are barely viable, ones receiving external Technical Assistance and those that are not. The absence of such a model cautions against the perils of generalizing to broadly here.

To its credit, WOCCU is trying to develop a “model credit union” approach. This approach institutionalizes a business orientation and financial management disciplines in credit unions through six program components: 1) institutional strengthening, 2) focus on savings mobilization and marketing, 3) credit administration, 4) legal framework, 5) training and 6) short-term Technical Assistance. In Guatemala and elsewhere this methodology has led to rapid savings growth. In turn, this has led to excess liquidity. Excess liquidity allows lending growth and the end of credit rationing which affected many credit unions. In some cases (e.g. Ecuador), WOCCU has followed this financial strengthening with attempts to market and to develop specific products for microentrepreneurs.

Yet in Ecuador, only 26 of the approximately 360 credit unions are regulated by The Superintendency of Banks. This group of 26 credit unions encompasses 70 percent of the assets of all the country's credit unions. At least for the limited number of credit unions visited, performance compares well with the new credit techniques of microfinance. All had reached significant scale and depth of outreach, and all except the very newest were financially sustainable. In fact, they had reached the most advanced level in microfinance—credit programs fully financed from savings, with interest fees covering their real cost of funds, operations and inflation.

Some credit unions clearly are viable microfinance providers as defined by the types of activities financed, the size of the loans and type of their guarantees, and loan terms. With roughly 20 million members in the developing world, credit unions form an enormous potential delivery system for microfinance. Credit unions neither exclude the poor, nor work exclusively with

them. By adopting specific methodologies like solidarity groups and village banks, which had their origins in credit unions, they can reach vast numbers of poor, marginalized people. As MacGill (1994) points out, credit unions in the developing world have already accumulated considerable experience in the provision of small-scale savers and borrowers. Among those that have relevance for the microfinance community are character-based lending, risk management, savings mobilization, low-cost delivery mechanisms, financial system development, portfolio management and operational management systems.

The Superintendency of Banks in Ecuador has changed the regulations for credit union governance. Credit committees have been eliminated and decision-making authority over loans has been given to professional managers and their staff. The basic requirements for membership on the Board of Directors have been increased as well. These changes were supported by WOCCU, which sees governance as one of the key issues facing credit unions.

Among the problems identified are:

- One person one vote leading to borrower domination,
- Unqualified personnel in decision-making oversight (volunteer board members often lack the expertise to manage a financial institution),
- Lack of clear rules for decision-making,
- Lack of competitive salaries to attract quality professional management,
- Failures of boards to exercise fiduciary responsibility.

While the credit unions visited in this study generally had strong board leadership and capable professional management, this was not true of other credit unions in the same three countries.

C. METHODOLOGICAL DISSEMINATION

On May 12th, 1999, a roundtable panel of experts was convened to discuss the draft conclusions and recommendations of the study. The panel consisted of academics, donors, and PVO/CDO practitioners. Much of the discussion centered on the concept of “hybridization”. While there was general agreement that methodological diffusion was taking place, and that this was generally a positive trend, several cautions were raised.

The first, involved precision in language. Terms such as networking, partnering, linking, grafting and cross-pollinating were all used. It was determined that strong organizations are the most important factor in predicting success in microfinance. With hybridization, the concern was that each institution might lose its identity and integrity. Conscious borrowing of methodology was seen as “grafting”, while jointly influencing each other’s methodologies and systems was seen as “cross-pollinating”. Networking, partnering and linking can effect both grafting and cross-pollination.

Second, grafting and cross-pollination are not always done well. It was agreed that the examples from Bolivia, Ecuador and Burkina Faso were all successful. The concern is that the borrowing

goes off target and the methodology is misapplied, undermining the methodology and not truly learning from the people who initiated it. Partnerships need to be carefully chosen.

Third, grafting or cross-pollination without consideration of context can lead to a cookie-cutter approach. Cultural, demographic and macroeconomic conditions may all make a particular methodology inappropriate in a give context.

D. SPECIFIC WAYS TO IMPROVE COOPERATION BETWEEN NGOS/CDOs

Individual organizations (both PVO and CDO) have both common interests and competing ones. In the long-term all these organizations, plus donors, want to promote the development of financial systems that give opportunities to different classes of people including the poor to access as many financial services as possible. In the shorter term, implementers are worried about a zero-sum game and maximizing their competitive advantages. Cooperation therefore needs to be around creating a supportive policy environment and increasing the funds available from both donors and commercial sources. The Seeds of Hope Program in Africa and Kenya in particular are seen as a possible test case for coordination of effort.

Specific suggestions to improve cooperation between PVOs and CDOs include:

- Invite PVOs on CDO evaluation teams and vice versa;
- Set up working groups on regulatory issues between USAID, CDOs and PVOs in a limited number of countries. In some cases this can be based on existing in-country networks;
- Share information and practices on specific products (e.g. long-term loans, passbook savings) between PVOs and CDOs. Savings has been on the MFI radar screen for several years, yet little has been done;
- Examine which part of PVC's assistance is a private good intended to provide capacity-building support to a specific institution, and which part of it is a public good, intended for planned dissemination to the broader PVO/CDO community;
- Demonstration of some level of initiative and interest on the part of PVOs and CDOs for continued dialogue by setting up low cost communication mechanisms like e-mail listserves, before USAID provides any funding support;
- Examine contracting barriers to fostering collaboration between PVOs and CDOs (e.g. Cooperative Development grant restrictions);
- Examine where MFIs could team up with cooperatives to design and market loan products to their members.

CHAPTER VII: RECOMENDATIONS

A. COOPERATIVES

1. **Each CDO must make a strategic decision on how core microenterprise (and more specifically microfinance) is to their vision/mission/project portfolio.** Each CDO can make a strong case for its ties to microenterprise. Some provide access to savings and credit as their primary intervention, others provide credit on an as needed basis or leverage access to credit for their cooperative partners. Many have specialized staff in microfinance, others do not. Some are very active in SEEP, while others are not members at all. All seem at least somewhat interested in learning more about the sector and accessing more funds. There was a concern expressed that cooperatives were the originators of microenterprise development and were not getting the recognition or support they deserved. What is required is for each individual CDO to decide whether or not microenterprise is (or should become) a core institutional strategy.

Assuming a positive response to # 1 above, the following recommendations are made

2. **Learn to speak the language.** The team was extremely impressed with the CDO projects visited in the field study. In more than one case, however, a project manager of a program specifically funded in microfinance was unfamiliar with current terminology used in the field and had not read any of the best practice literature. Focus on cooperative approaches is fine. Staff, however, need to know what is going on in the broader microenterprise community and participate in local networks.
3. **Further explore with the PVO community their individual ties to microenterprise.** There is no doubt that infrastructure is key to microentrepreneurs. Electricity leads to the possibility of power tools that can allow a microentrepreneur to make things better, faster and cheaper. Telephones are vital marketing tools even for microenterprises (as Grameen Bank has recently concluded). In addition, insurance is one of the new frontiers of microfinance and agricultural sector studies are potentially important to PVOs working in rural areas. Some CDOs need to explore and document more fully their ties to microenterprise. Once that is accomplished they are in a position to negotiate partnerships or joint efforts with the PVO community (See WOCCU/ FFH and CHF/Plan International in the body of the report.)
4. **Get good numbers.** PVC struggled, and still struggles, with PVOs to get good reporting data. Each CDO needs to have ready access to basic data such as how many people it is reaching? How many of them are microentrepreneurs? How many of them are poor? This is easier for those coops involved in microfinance. In some instances in trying to put together data for this study, we found apples and oranges comparisons with the PVO data. If CDOs want to access donor funds for microenterprise, they need to gather consistent data.

5. **Get involved in SEEP as individual organizations.** NCBA is the current Board Chair of SEEP. WOCCU has previously held that position. ACDI/VOCA recently made a presentation on rural finance. In addition, CHF received a sub-grant from SEEP to develop analysis tools for housing finance and has learned some of the microfinance techniques it uses in its non-housing microfinance efforts. Other CDOs have not taken part in the network at all. Joining SEEP would provide an opportunity to get their institutional agenda on the table and do some learning about the field as well. WOCCU's activity in SEEP has waned recently as well. This is for understandable reasons (staff reorganization, focus on internal issues, distance from the east coast where many meetings are held). WOCCU's potential contribution to discussion on savings mobilization is key to moving the entire community along and can give them external recognition which, in turn, can lead to donor interest.
6. **Get specialized technical staff.** The team came away highly impressed with the quality and depth of the CDO staff we met. They came from a variety of backgrounds including agronomy, animal husbandry, training, organizational development etc. In some cases, the credit expertise came from people who had cooperative and/or farm credit background here in the U.S. Those CDOs who decide to commit to the microfinance sector must have staff with very specialized background and experience.
7. **Learn to market cooperative service businesses as a sustainability mechanism in other sectors.** Having, in many cases, achieved sustainability in microfinance, many PVOs have unsuccessfully taken on the challenge of using business principles to ensure the sustainability of interventions in other sectors. NCBA and Land O'Lakes (through its Cooperative Development sub-grant with Health Partners) have come up with some exciting advances in providing health insurance and health care through cooperatively owned businesses. In Uganda, payment of premiums is in milk collected at the local dairy co-op. NCBA also has successful experience in the cooperative management of natural resources. Lessons learned need to be extracted and documented for dissemination to the broader development community.
8. **Define a common cooperative approach.** With the CDOs active in markedly different sectors, the only commonality seems to be the basic cooperative principles. Some of the CDOs maintain that some of their colleague institutions have gone so far afield from their original cooperative roots, that the co-op principles no longer tie them either. If the CDOs want to access donor money as individual institutions, they are already doing it. If they want to do it as a sector they must define what is unique about their approach. This might best involve functioning as a learning group within SEEP. This would have several advantages. It would 1) involve the Canadian CDOs in the discussion, 2) involve PVOs that also engage in cooperative development and 3) involve a built-in PVO/donor audience for the intellectual product. OCDC is another potential institutional home for such discussions. Given the representational nature of that institution and the advantages cited above, SEEP was seen as the preferable venue. OCDC is certainly an acceptable place to begin the discussions.

B. WOCCU

In addition to the recommendations to the broader CDO community above, the following specific recommendations are made to WOCCU

- 1. Extract lessons learned from its experience in Credit with Education in the Philippines and disseminate the model with FFH and additional partners.** To its credit, WOCCU saw credit unions comparative advantages in microfinance and actively sought partnerships with PVOs. As clearly demonstrated by the partnership between credit associations and credit unions in Burkina Faso, this “hybrid” is an important one. It raises the possibility of soaking up excess credit union liquidity, raising membership and credit union profits, while at the same time massifying village banks and finding them an appropriate institutional home.
- 2. Maintain core funding and develop tools for developing the model credit union approach, while avoiding a “cookie cutter” mentality.** The model credit union approach is an obvious success and represents a major lesson learned from WOCCU’s previous focus on Leagues or Federations. It has contributed to major gains in membership, savings and loan volume in several countries in Latin America, while at the same time lowering delinquency. Its current challenge is to design model tools, policies and bylaws to support the model. It must do this, however, while maintaining flexibility in program design. One respondent, when asked about the possibility of a cookie cutter approach proclaimed, “a cookie cutter is a way to make a lot of something valuable in a cost-efficient way.” WOCCU must learn from its Bolivia, Philippines and Ecuador projects how to add support for solidarity groups and village banks from below and banking products from above.
- 3. Learn what to do with the non-viable credit unions in the model credit union approach.** In Ecuador and elsewhere, a small percentage of the credit unions are viable and growth oriented. The others, while in some cases providing marginal services to members, they dominate the national federation based on the rule of one credit union one vote and damage the reputation of credit unions more generally. The WOCCU-affiliated credit unions in Ecuador are struggling with the issue of mergers, acquisitions and liquidations. Other countries are doubtless in the same situation. While WOCCU’s focus on a few dynamic credit unions is not in question, they must learn some answers to this problem.
- 4. Continue to work on governance issues.** WOCCU has rightfully identified governance as a key issue for the credit unions it supports. It recently wrote a paper on the subject for the Inter-American Development Bank. Now that progress has been made on financial strengthening, credit and savings product development and marketing, governance has to be a focus issue. WOCCU’s work on governance can inform PVOs, which face similar issues.
- 5. Encourage successful credit unions to join the Microfinance Network.** Best practice credit unions compare favorably with any other MFI. By joining MFN, they get the opportunity for technical exchange with peers, personal recognition and the chance to join key microfinance discussions.

6. **Create its own network of credit unions providing tailored products and methodologies for microenterprise.** As a group, they could build on their comparative advantages, determine rules of performance and conduct, develop a reporting system, and specify goals and standards for the quality of their services.
7. **Support member research/market studies of their credit union partners.** Traditionally, credit unions have not done marketing analysis in developing countries, particularly of their microenterprise members. Recently WOCCU has provided support to its partners in conducting member surveys. Credit unions need to know more about the credit and savings needs of their microenterprise members so they can plan services to meet those needs.

C. USAID

1. **Market the impact of the Matching Grant and Cooperative Development Programs with help from the PVO/CDO community.** There is considerable anecdotal evidence of the impact of the grant mechanisms. All respondents interviewed spoke of the importance of the grant in building their institution's capacity in the sector. In addition, data from the local institutions supported by grant recipients shows tremendous growth. It has been hard for PVC, however, to document its impact. Improvements in indicators from MFIs in the field are usually captured in USAID Mission figures as opposed to by PVC; much of the early records of the grants have already been archived, making a historical overview difficult; and improvements in PVO/CDO capacity and the link to local institutional and client level impacts are hard to measure. Several PVOs and CDOs have offered to work with PVC to better tell this story.
2. **Make the cooperative development grants more competitive.** This can be accomplished in two ways. The first is to bring in new players. There are an extremely limited number of applicants for the grants and each applicant usually gets something. PVC should aggressively pursue new applicants. With sub-grants to new CDOs now being implemented the chance exists to increase the pool from which to choose. A second way to increase competition is to push for a greater disparity of funding levels. Currently the levels of funding are almost identical. This leads to a situation where quality is not rewarded and some institutions have come to see the grant as an entitlement.
3. **Choose what stage of institutional development in microfinance PVC is willing to support with its partners.** PVC has supported the start-up and expansion of some of the largest, most successful microenterprise support PVOs. It continues as well to support new entrants. PVC legitimately questions when more advanced PVOs will "graduate" and when to stop funding "more of the same". The need for a core Research and Development function continues indefinitely. In the new environment of scale and rapid expansion, microenterprise development organizations have to deal with ever changing issues and challenges. Some cannot raise all the core funds needed to maintain their technical assistance function. PVC should consider funding the maintenance of such capacity as a public good, require some mentoring and expect specific products for planned dissemination

to the broader community. This would not only help support PVC's new partners; it would protect their prior investment old ones.

4. **PVC should sit down with potential grantees and the Microenterprise Office to coordinate support.** There seems to be some level of coordination between PVC and the Microenterprise Office. Staff from the Microenterprise Office sits in on Matching Grant reviews when appropriate. In current circumstances, however, many PVOs divide up their programs and approach the two offices separately. It would be far better for the two offices could sit down together with the PVO to define an optimum funding package given the quality of the proposals, the level of funding available, consistency with USAID objectives and the goals of each office.
5. **PVC should not encourage new entrants in highly competitive markets.** There are an increasing number of countries in which competition is intense. In Bolivia there was even talk of a shakeout of institutions in which some simply closed their doors. It is unwise to invite new players into such circumstances. There is also the concern that new entrants could lead to market distortion with high delinquency. PVC, in consultation with the Microenterprise Office and the Regional Bureaus should come up with a list of countries in which new entrants will not be encouraged with Matching Grant funds.
6. **Require all new recipients of Matching Grants Program to meet the requirements of the USAID microenterprise policy, best practice and reporting from the beginning of their grant.**
7. **As more is learned about how to differentiate levels of microfinance market development, the Agency must have a package of tools to use at each level.**
8. **USAID should have highly trained technicians at each Mission heavily engaged in the sector.** Part of the success of the microfinance sector in Bolivia appears to be from steady support over a significant period of time. The quality of microenterprise staff at the Mission was key in the success of important policy and supervision changes.

PVOs

1. **Pursue natural partnerships with CDOs in areas such as housing lending, insurance for microentrepreneurs and institutional homes for village banking and Credit with Education Programs.**
2. **Make sure that CDOs are involved in public forums.**
3. **Move on the issue of savings mobilization.** Attracting savings is increasingly necessary, as external financing becomes more scarce. In addition, savings services are very much in demand by clients. MFIs have been relatively unsuccessful in mobilizing small sum savings. Many capture savings from large institutional investors. Schmidt and Zeitenger (1995. P.95)

point out that big savings accounts expose financial institutions to considerable liquidity risk because these funds can easily be withdrawn. This should be high on the PVO technical agenda and the credit union movement is a potential resource.

4. Work on cutting edge issues such as

- **Expanding out to rural areas**
- **Improving MIS systems**
- **Supervision**

APPENDIX

- I. Table to Accompany Chapter III
- II. Cooperative Development
Organizations

APPENDIX I
TABLE TO ACCOMPANY CHAPTER III: Selected Group of MFIs

Institution/Year Founded	Institutional Structure Lending Methodology	Owners	PVO or CDO Affiliation
<p>BancoSol Converted from NGO, PRODEM, into bank in 1992.</p>	<p>Commercial bank. Solidarity group lending methodology and increasing use of individual lending.</p>	<p>1. NGO PRODEM (sold stock in March 1999 to investment company of British international development agency). 2. PVOs (Calmedow, ACCION Int'l). 3. Int'l Funds (Gateway, Profund, SIDI). 4. Private Bol. Funds (CODVI, INBO, COMSUR). 7. Individuals.</p>	<p>Affiliated with Accion International and the Microfinance Network. Has received support from various international donors.</p>
<p>PRODEM Established in 1986 as an NGO. Currently in process of becoming a PFF.</p>	<p>NGO to be converted into a Fondo Financiero Privado. Solidarity group lending methodology and increasing use of individual lending.</p>	<p>Founded by influential businessmen with the support of ACCION Int'l. As an NGO, does not have "stockholders." It has 15 Fiduciarios that provide guidance to five directors (PSIC, 1998). Directors include: a former Citicorp officer; a former Superintendency of Banks officer; a former private enterprise officer; and a former Minister. It is expected that 71 percent of PFF will be owned by NGO PRODEM and 29 percent by 16 shareholders, each subscribing 1 percent to 5 percent of US\$5 million initial capital. Proposed Board for PFF includes: a former President of Bol. Bank Assn.; a former President of Bol. Conf. Of Private Enterprises; a former Ambassador to the United States; a former President of Bolivia; and a Washington-based Bol.</p>	<p>Affiliated with Accion International and the Microfinance Network. Has received support from various international donors.</p>

		Consultant.	
Institution/Year Founded	Institutional Structure Lending Methodology	Owners	PVO or CDO Affiliation
Caja Los Andes Established in 1992 as Pro-Credito, an NGO. Converted into PFF in May 1995.	Fondo Financiero Privado. Individual lending methodology.	Founded with the support of the Swiss Development Agency (COSUDE) and with technical assistance from the German consultant company IPC. PFF's stockholders include: Asociacion Pro-Credito (NGO), 38.9 percent; Inter-American Development Bank (Donor), 22.6 percent; Corp. Andina de Fomento (Mixed), 12.98 percent; (COSUDE), 6.43 percent; Individual investor, 9.55 percent; Individual investor, 6.31 percent; Individual investor, 3.24 percent.	Affiliated with the IPC (Germany) network. Has received support from various international donors.
FIE Established in 1985 as an NGO. Converted into PFF in March 1998.	Fondo Financiero Privado. Individual lending methodology.	Founded by influential woman with the support of other individuals and the IDB. Individual investor, 59.6 percent; Individual investor, 10 percent; Johnson Foundation, 15 percent; COSUDE, 10 percent.	Has received support from various international donors.
CRECER Established in 1990 as a FFH subsidiary. FFH has operated in Bolivia since 1986.	NGO with a "credit with rural education" program started in 1990 with a village bank lending methodology.	Foundation's equity mainly from FFH and grants from USAID.	Affiliated with Plan International, Save the Children and FFH. Received grant from USAID ME Dev in 1995 to develop local MFI.

Institution/Year Founded	Institutional Structure/Lending Methodology	Owners	PVO or CDO Affiliation
<p>Jesus Nazareno Credit Union</p> <p>Established in 1963 as a savings and credit cooperative or credit union.</p> <p>In mid-1980s, after the financial crisis, the credit union had lost almost all its assets.</p>	<p>Credit Union: Non-bank regulated financial intermediary.</p> <p>Individual lending methodology.</p> <p>Applying solidarity group methodology for the past 5 years.</p>	<p>Founded by group of 65 low-income parishioners of Jesus Nazareno parish in Sta. Cruz. Eighty percent were women.</p> <p>Owners: 68,058 low-medium and low-income members or shareholders. The nominal value of each share (<i>certificadode aportacion</i>) is US\$20. A shareholder must subscribe one share per year to maintain his/her membership.</p>	<p>Receiving technical assistance from the WOCCU project.</p>
<p>Montero Credit Unions</p> <p>Established in 1963 as a savings and credit cooperative or credit union.</p> <p>In mid-1980s, after the financial crisis, the credit union had lost almost all its assets.</p>	<p>Credit Union: Non-bank financial intermediary, reporting to the SBEF but still waiting for license.</p> <p>Individual lending methodology.</p> <p>Also, using solidarity group methodology since 1998.</p>	<p>Founded by a group of low-income people in Montero, a rural community close to Sta. Cruz working in sugar producing farms (<i>ingenios</i>).</p> <p>Owners: 6,887 low-medium and low-income members or shareholders. The nominal value of each share (<i>certificadode aportacion</i>) is US\$10. A shareholder must subscribe one share per year to maintain his/her membership.</p>	<p>Receiving technical assistance from the WOCCU project.</p>
<p>Agrocapital</p> <p>Established in 1992 as an NGO.</p> <p>Submitted application to become PFF in March 1999.</p>	<p>Foundation/NGO.</p> <p>Individual lending methodology.</p>	<p>NGO's equity formed with USAID grants.</p> <p>Proposed investors for FFP:</p> <p>Agrocapital NGO: almost 60%</p> <p>ACDI/VOCA</p> <p>CORANI</p> <p>CAF</p> <p>Two individual investors</p>	<p>Receiving technical assistance from ACIDI.</p>

II. COOPERATIVE DEVELOPMENT ORGANIZATIONS

World Council of Credit Unions (WOCCU)

The World Council initially emerged from a US institution, the Credit Union National Association (CUNA). Seeing the benefits credit unions could provide for the developing world, CUNA organized its World Extension Department in the mid-1950s. By the late 1960's, the present structure of the international system evolved, with the establishment of credit union confederations in each major region and the formation in 1970 of an international organization for credit unions; the World Council of Credit Unions.

The World Council of Credit Unions is the apex organization of the international credit union system. This system encompasses credit unions and related cooperative financial institutions in 86 countries. WOCCU is thus a trade association representing 90 million individual credit union members. Membership in WOCCU itself is comprised of regional confederations, national associations, cooperative associations and business/service organizations (primarily those providing insurance to credit unions). WOCCU recently used Cooperative Development Program grants to re-organize itself to increase its capacity to serve its members.

WOCCU, however, is also a development organization currently implementing credit union development programs in Asia, Africa, Central/Eastern Europe, the Caribbean and Latin America. While a high percentage of credit union membership is concentrated in North America, over 20 million credit members reside in other regions, making credit unions one of the largest providers of financial services in the developing world. Since 1980, WOCCU has implemented more than 100 substantive regional and country-level credit union development projects. Projects have ranged from half a million dollars to almost \$10 million, and from 12-60 months of duration. Current figures indicate 22 projects valued at almost \$46 million. WOCCU is one of the least USAID-dependent CDOs, with USAID funds at 67% of revenues.

With its long history, WOCCU has been involved in the evolution of credit unions as players in the microfinance sector. In the 1960's, the financial sector landscape was comprised primarily of the formal banking sector and informal finance such as loan sharks and ROSCAs. Banks neither accepted savings from small account low-income groups, nor made small or rural loans to such people. Credit unions offered the only semi-formal alternative. Therefore, donor funds for credit unions were plentiful, and WOCCU was good at accessing them. Missionaries and Peace Corps volunteers started numerous credit unions, which had a strong social welfare purpose: assisting the poor in mind. According to Jeff Poyo (1987), these credit unions generally lacked professional management, were weak at loan recovery and earning profits for future expansion, and usually kept loan interest rates very low to benefit borrowing members.

Low lending rates meant that deposit rates were also generally kept low. With substantial grant and soft loan funds available through external donors, many credit unions continued to grow rapidly, despite the lack of deposit mobilization, loan recovery and retained earnings. During this period WOCCU (pushed by donors) focused on a "trickle down" strategy with an emphasis on formation and subsidization of national credit union federations to "efficiently"

spread a simple uniform methodology. However, the proliferation of many small credit unions with a negative return to savings, cheap loans and high delinquency led to stagnation by the 1980s. Credit union penetration remained at less than 1% in Asia and with exception of the Caribbean remained low elsewhere as well. This led to the emergence of alternative NGO financial institutions to fill the credit union niche. The credit unions, in effect, created their own competition.

WOCCU realized that the overall credit union track record required a re-thinking of credit methodology, damage control, and competition with the new providers of microfinance (Village Banks, Solidarity Groups, and Commercial Banks going down market. This led to the development of the “Model Credit Union” approach, based on work initially done in Guatemala (in part with Cooperative Development grant funding).

The Guatemala model includes setting and tracking standards, establishing favorable policies, and improving service quality. Financial standards are summarized in the “PEARLS” system (Protection, Effective Financial Structure, Asset Quality, Rates of Returns and Costs, Liquidity and Signs of Growth). This is used as both an executive management tool allowing managers to pinpoint trouble areas, and as a standardized set of evaluation ratios and formulas to achieve greater uniformity and strength in the quality of each individual credit union. This set of indicators has replaced the more common CAMEL system and WOCCU has trained regulatory authorities in its use.

Credit union policies that WOCCU works with in most of its projects include bylaws, lending policies, collection policies (based on strict follow-up and aggressive collections), savings policies, internal controls, investment policy, asset liability management, business plans and annual marketing plans. Services include the two basic services involved in financial intermediation savings and credit. Savings principles include market rates, real returns and access. Loans include entrepreneurial rates and a broad range of products (including those specifically designed for microenterprise.

This required a radical change of strategy for WOCCU. They began to bypass national federations in order to work (at least initially) directly with viable credit unions. The idea was that the newly strengthened credit unions would get to a point where they were increasingly willing to support and purchase services from the federation. Previous external support from donors had in some cases failed to lead to strong federations.

The methodology includes:

- 1) Conducting a diagnostic of the financial condition of the credit union; its services, policies and procedures; its loan portfolio quality; and market potential; (In many countries 20% of the credit unions have mobilized 80% of the resources. WOCCU realizes that it has to be very selective and work only with those that have the potential for viability and growth);
- 2) Creating a business plan for the credit union based on priorities identified in the diagnostic which defines a growth strategy;
- 3) Drawing up a formal contractual participation agreement;

- 4) Implementing the partnership including technical assistance, training and (in some cases) financial assistance;
- 5) Monitoring and evaluating the credit union based on its financial condition and growth, to track results and enforce commitment; and
- 6) Renewing, modifying or terminating the agreement based on results.

In Guatemala and elsewhere this methodology has led to rapid savings growth. This, in turn has led to excess liquidity. Excess liquidity allows lending growth and the end of the credit rationing which affected many credit unions. In some cases (e.g. Ecuador), WOCCU has followed this financial strengthening with attempts to market to and develop specific products for microentrepreneurs. In one recent two year period in Guatemala, loan volume increased approximately 85% from \$25 to \$46 million, savings nearly doubled, and membership grew by 65%. In that same period, credit unions supported by the grant provided 172,000 microentrepreneurs with access to credit.

Despite its success, WOCCU faces many challenges. These include:

- Dealing with its dual roles as a membership organization having to supply services to members, and an international development CDO;
- Getting credit union managers and WOCCU technical people to speak the language of microfinance (There are currently WOCCU Managers on Projects explicitly targeted to microentrepreneurs who are not familiar with current terminology or best practices in the sector);
- Responding to their competitive set including PVOs and for-profit consulting firms offering to do credit union development, NGOs with alternate microfinance methodologies, and banks moving down market;
- Maintaining the core funding necessary to develop the key tools needed to define, package and expand the model credit union approach;
- Learning from and expanding the opportunity to work with credit with education programs such as Freedom from Hunger in Philippines. This has the potential to increase membership, deepen outreach and soak up excess liquidity;
- Increasing its dialogue with PVOs (activity in SEEP has become relatively limited) ;
- Tracking results and marketing its story (WOCCU needs to have better data on the percentage of credit union lending going to microenterprise. This study is intended, in part to tell the credit union story. WOCCU has to tell it as well, particularly emphasizing credit unions role in savings-based microfinance and the many lessons it has learned on governance issues);
- Experimenting with different models to provide credit union technical assistance post donor funded intervention (This is a particular issue since federations are often no longer an option for continuity). In some countries WOCCU technicians are considering becoming a consulting firm post-project. In others the Superintendency of banks will become the repository of credit union knowledge. WOCCU needs to find ways to support such efforts;

- Adapting the “Guatemala” model so that it is appropriate in a broad array of settings and moves beyond effective financial strengthening to a focus on new product development. Some former WOCCU staff expressed concern that the model credit union approach had become a cookie cutter. Other current and former staff respond that the purpose of a cookie cutter is create large quantities of a proven product. WOCCU must strive for a medium between considering each program unique and thus having nothing to learn from its predecessors, and believing that everything must fit with previous lessons learned. WOCCU’s program in Ecuador has made changes to the PEARLS system and developed 11 loan products specifically designed for microentrepreneurs. It is this type of innovation that must be encouraged.
- Establishing policy as to what to do about dormant, non-viable credit unions. In Ecuador, for instance, only 10% of the existing credit unions are judged to be potentially viable. Should the others be liquidated? merged?, left to flounder on the best they can?

ACDI/VOCA

ACDI/VOCA was formed in 1997 through the merger of Agricultural Cooperative Development International (ACDI) and Volunteers in Cooperative Assistance (VOCA). While practical realities, rather than strategic vision primarily brought about the merger, there do seem to be some legitimate synergies. ACDI/VOCA is attempting to combine the two previous organizational approaches to capacity building: one based food systems and the other focused on the grass roots. The combined organization has created teams on which expertise from both perspectives is brought to bear.

As the international branch of the National Council of Farmer Cooperatives, ACDI/ VOCA is a membership organization of US agricultural cooperatives, farm credit banks, and national associations of farmers and cooperatives. NCBA another CDO studied in this report is among the prominent members. The mission of the organization is to improve the economic well being of farmers worldwide by assisting agricultural and member-owned organizations to increase trade and achieve sustainable economic development.

ACDI/VOCA’s roots with USAID go back to 1962 and it is one of the largest CDO recipients of USAID funds. It currently implements 54 projects valued at over \$120 million, most of it with US government funds. While many of its interventions can be grouped under three broad headings (rural finance, capacity building and partnership), the scope of ACDI’s individual program activities is vast. Not only does it attempt to increase access to financial services; it disseminates appropriate production technology and strengthens its partners’ capacity to market their members’ products as well. A review of proposals and other documents shows that ACDI/VOCA has been involved in:

- Providing technical assistance to Business Support Organizations supporting small and medium enterprises;
- Creating a new allied non-profit corporation to attract funding by the US agribusiness community for overseas projects which are designed to enhance trade relationships;
- Conducting the monetization of agricultural commodities;

- Supporting export marketing efforts;
- Improving input supply and post-harvest storage;
- Supporting two way farmer and agribusiness exchanges; and
- Working with a variety of partners (Foundations, NGOs, Cooperative Banks and Commercial Banks), using all three of the major lending methodologies (individual, village banking and solidarity groups).

With such a diversity of partners, methodologies and activities, a key question for this study is what portion of ACDI's program is directly tied to microenterprise, and more specifically microfinance. Some of its interventions would be excluded because of the size of the business supported; others because USAID specifically excludes crop production from its definition. Despite ACDI/ VOCA's interesting work in business development services in Poland, for the purposes of this paper, the focus will be on its efforts in the area of rural finance.

ACDI/VOCA is using its Cooperative Development grant funds to enhance its capacity in rural finance. The goal is a rural finance department at HQ that will allow it to shift from a project approach using member and other outside resources on an ad-hoc basis, to a more comprehensive program approach with in-house institutional capacity. Three staff members have already been hired or assigned to the Rural Finance Department and a fourth will soon be on board. The emphasis being placed on rural finance demonstrates ACDI/VOCA's conviction that it is uniquely positioned to become a leading rural finance technical assistance provider.

The intent is to develop and test an integrated methodology of rural finance, capacity building and partnerships. Currently, ACDI/ VOCA tends to deal with these issues separately. The methodology will better integrate technical assistance for rural finance at the Cooperative banks, for example, with capacity building for its borrowers (farmers and cooperatives) and the development of long-term partnerships to facilitate technical assistance, people- to- people contact and business opportunities after projects end.

Rural finance has traditionally has performed very poorly. As ACDI/ VOCA points out in its strategy document, conditions in agriculture make it a difficult and dangerous sector to lend to. These conditions include seasonality of cash flow, high-risk based on the vagaries of nature and lack of crop diversification, inefficient production units and longer-term loan requirements than tradition quick-turnaround micro loans. General rural conditions such as small-scale, dispersed clients and lack of infrastructure make even non- agricultural rural lending a challenge.

ACDI/ VOCA has come to the fundamental realization that: "Just as agriculture is one key element of rural economic development, so agricultural credit is one financial service among many to be provided by a viable financial institution". They have developed a technology for rural finance which entails maintaining a commercial outlook, lending to off-farm microenterprise to diversify risk, in-depth assessment based on cash flow, pricing based on costs and risks, longer term loans and close supervision. This approach has been implemented in transforming several banks and up grading Agrocapiatal from a "program" into a successful

institution. With one of the major issues of microfinance being finding ways for institutions to reach more rural populations, ACDI/VOCA potentially has a lot to contribute.

ACDI/ VOCA faces the following challenges:

- Diversifying its funding base away from US government sources (i.e. USAID and USDA monetization). ACDI/VOCA must continue to market its rural finance expertise to other bilateral and multilateral donors;
- Using its years of cooperative development experience to work with US cooperatives and firms that are entering transitional or developing country markets. This will serve both as a cost recovery mechanism and a chance to create business opportunities for its members;
- Sharing its lessons learned on rural finance with the rest of the PVO/CDO microfinance community. ACDI/VOCA has already shared a rural finance case study based on the Agrocapital experience to SEEP. This kind of exchange should be continued. ;
- Deciding to what extent cooperatives are core to what they do. ACDI/ VOCA's stated position is that they work with associations and cooperatives if possible. They do not consciously force cooperatives in situations where for historical reasons they don't make sense. This is a defensible position and consistent with that of other CDOs. A number of people interviewed for this study expresses the concern that ACDI/VOCA goes so far afield so often that it runs the risk of becoming a "beltway bandit rather than a CDO;
- Establishing an equity investment in its institutional partners overseas. In Bolivia, ACDI/VOCA has a \$500,000 equity investment in Agrocapital. This allows it to provide continuous TA post project out of the dividends. Its presence on Agrocapital's Board of Directors also gives it influence over strategic direction.
- Integrating VOCA's 4,000 person short-term volunteer force into ACDI's long-term project staff.

Cooperative Housing Foundation (CHF)

CHF was founded in 1952 as a non-profit association dedicated to the development of housing and related community services for low and moderate-income families. At the request of USAID, CHF became involved in international work in 1962, and CHF International was officially established in 1965. CHF currently has programs in over 30 countries and a loan portfolio of more than \$13 million.

An interesting story is how CHF's program has evolved and expanded beyond its original cooperative housing base. According to CHF, one of its key lessons learned is that "housing is not a stand-alone concept. Decent housing requires supporting physical infrastructure. Economic opportunity requires that people have access to jobs, and businesses have access to credit. Healthy communities require good sanitary waste disposal, solid waste management, and preventive and primary health care systems." CHF now works with many partners that are not cooperatives in a variety of sectors other than housing. What is important for this study is their work with microfinance.

In the mid-1980's, CHF started housing credit schemes, making small, uncollateralized loans available to poor families for incremental housing improvements. The program initially used cooperatives, credit unions and other indigenous NGOs as intermediaries. CHF, using funds from the MacArthur Foundation, its own capital, and money from other sources, lent funds to the NGOs for five years that were, in turn, on-lent to borrowers for 18-36 months. CHF's efforts included attempts to strengthen NGO capacity.

The ties between housing lending and microenterprise were clear. According to the United Nations Center on Human Settlements,³⁷ Low-income families view housing not only as a secure dwelling, but as an asset that can a) house a business, b) directly generate rental income, and c) serve as a form of savings when it appreciates in value. Home-based businesses are very common among microentrepreneurs.

As Phelps³⁸ points out, a frequent strategy in housing programs had previously been to create public sector institutions to provide specialized and targeted shelter credit for development purposes. Because of the complex operating incentives under which such entities functioned, their success had, at best, been mixed. As a result USAID began investing resources to strengthen the willingness and ability of private sector institutions to provide credit for shelter. This led to an investigation of microfinance.

Many similarities were found between shelter and microfinance programs. These included: 1) clientele, 2) operation in the informal sector (both shelter and income-generating activities are often carried out informally, incrementally, and in ways that minimize risk to the household.), 3) a focus on creating sustainable institutions, and 4) the development of appropriate services that are responsive to need.³⁹

Other MFIs are providing (or are planning to provide) housing credit for shelter. These include the Grameen Bank, BRAC, BRI, and credit unions. Diversifying the portfolio of these institutions is positive both for their clients and the institutions themselves. Since shelter loans differ greatly in size and term from traditional microfinance loans, and are for a "non-productive" purpose, new analysis tools are necessary. CHF developed expertise in microfinance for housing that it is synthesizing and sharing with the broader PVO community. CHF developed a self-assessment tool for PVOs and NGOs to examine adding home improvement loans to their portfolios.

The collaboration of CHF and Plan International is a very interesting hybrid. Plan is a large, multi-sectoral PVO with an involvement in "habitat" (potable water, sanitation, and housing) ranging from \$60-80 million a year. Even with a 10-25% community in-kind contribution, Plan saw its housing as primarily a give-away. With a single house costing \$1,500 to \$2,000, 7-10 years of child sponsorship was going into one dwelling, not a good way to get benefits out. The Global Environment Office at USAID invited CHF to do an assessment of Plan's habitat

³⁷ Cited in Phelps, Priscilla M. Building Linkages Between the Microenterprise and Shelter Sectors: An Issues Paper. USAID, Sept. 1995

³⁸ Ibid.

³⁹ Based on outputs of a USAID-sponsored workshop on housing held April 26, 1995

program in six countries. Based on this evaluation, CHF and Plan are jointly establishing a self-sustaining model for housing and credit.

This is tied to PVC's on-going support to improving Plan's microenterprise program. Plan chooses local microfinance NGOs; CHF then helps evaluate the NGO and their capacity to deliver housing credit. Finally both institutions work with the NGO to add the new directed-credit product. According to Plan, the relationship has caused CHF to learn to go "deeper" than it traditionally had, improving its capacity to reach poorer clients.

A final step of CHF's evolution involved expanding lending programs to microenterprise per se (particularly those operated by women or associated with housing). CHF is currently involved in microfinance in Asia, Latin America and the Middle East. CHF has studied best practices in the sector and its credit principles could be taken from any specialized microfinance PVO. It uses a variety of methodologies from providing guarantees to commercial banks to working with village banks. CHF self-reports that 21% of its program is pure microenterprise.

CHF faces the following challenges:

- Further exploring their synergy with credit unions. In many CHF programs in the Caribbean, credit unions were the main credit mechanism. CHF has assisted credit unions in several developing countries develop home improvement programs for their members. Possible formal partnership with WOCCU should be explored;
- Successfully completing its partnership with Plan and aggressively marketing its services to other PVOs pursuing a joint housing and microfinance agenda;
- Continuing to explore exit strategies for its work with commercial banks. Transfer of portfolio post-project is something which has to be studied very carefully;
- Dealing with the issue of subsidies. Even with microfinance, decent housing remains out of the reach of many poor people. Donors therefore will continue to provide subsidies. CHF maintains solid best practice microfinance principles, but must focus on learning to work with (e.g. S. Africa) subsidized programs in a sustainable way.

National Cooperative Business Association (NCBA)

Founded in 1916 as the Cooperative League of the USA, NCBA is the oldest cooperative development and trade association in the United States. With over 300 cooperatives and federated organizations in farm supply, agricultural processing and marketing, banking and finance, insurance, housing, healthcare etc., it is also one of the largest. NCBA is the US representative to the International Cooperative Alliance.

NCBA's assistance to developing countries began in India in 1953. Since that time, International Development has become one of the organizations three major Divisions and NCBA has managed more than 100 programs in 39 countries. At any point in time, it manages approximately 15 projects valued at \$10 million. It has performed hundreds of short-term assignments in other countries as well. In addition, NCBA set up Cooperative Business International (CBI) as a for-profit subsidiary, to facilitate and promote worldwide trade. CBI's

volume of business has exceeded \$300 million in imports, exports and joint ventures between U.S. businesses and those of developing countries.

While NCBA works with groups that are not formally registered cooperatives, it has one of the purest cooperative approaches of any of the CDOs. Because it focuses on Africa, NCBA has had to develop strategies for working around institutions that call themselves cooperatives, but are, in fact, government parastatal organizations that are more interested in implementing agricultural and social policy than in the economic well-being of their members. More often than not, they have a subsidized agenda that is not sustainable. NCBA works with private sector businesses which are member owned, democratically operated, and benefits its members with purchasing marketing or other services which are not otherwise available to them. It works with the poorest of the economically active.

Aside from providing training, management and technical advice to group-owned businesses in market-oriented business development, NCBA's methodology has several elements:

- Obtaining direct access for cooperatives to reliable sources of credit (generally by working with commercial or cooperative banks through guarantee funds which decrease as cooperatives demonstrate their capacity to repay),
- Making functional literacy an integral part of cooperative management training,
- Developing indigenous CDOs composed of former NCBA local staff to continue to provide training, organizational and other services to cooperatives after NCBA project intervention ends.

NCBA's role in rural credit has primarily been one of providing loan guarantees and intermediation. This comes from the belief that project-managed credit in W. Africa can not become sustainable at the level of loan size needed by cooperatives in a reasonable period of time. Early on in its African experience, NCBA approached commercial banks. In Mali, five commercial banks dropped the guarantee fund after two years (the fund was never used) and entered into competition for the business of rural cooperatives. The banks have lent a total of several million dollars to co-ops with a 98% repayment rate.

In Niger, The two major constraints cited by banks in dealing with rural organizations were the costs of administering rural credit portfolios and potentially low repayment rates. From the borrowers' perspective, access to banking facilities and the cumbersome loan approval were seen as problems. At a workshop of cooperative leaders, bankers, NCBA and USAID staff, it was decided that an intermediary credit service would be an appropriate structure to facilitate rural credit. What was needed was a low cost bridging mechanism capable of linking the resources of the formal sector with the needs of the rural sector.

NCBA set up a credit service that does not handle money or advocate a supply driven approach to credit. Rather it sells its expertise to borrowers (cooperatives and other group businesses) and lenders. The credit service stresses (and teaches cooperatives how to produce) bankable loan applications, repayment performance, credit worthiness and financial viability from its rural clients. It does loan analysis (along with the bank), helps tailor terms and conditions to the needs

and business cycles of the co-ops, monitors disbursement, provides up to date information on loans on a daily basis and engages legal procedures for the recovery of loans.

The credit service is expected to build up a performance record that can be sold to lending institutions. Fees are charged to loan clients from the beginning and gradually increased over time. The banks are initially attracted by the loan guarantee provided by the donor. However, once a track record is established, the guarantee is phased out and a fee is also charged to the lender. Over time, the fees cover all the operating costs of the credit service, which becomes a sustainable institution.

Over time, NCBA has developed best practices for rural credit intermediation. It has also learned some interesting lessons on how to help cooperatives obtain credit in liquidity- starved financial systems with poor repayment records. This experience has been shared with the broader PVO/ CDO community through its active involvement in SEEP, which is currently chaired by NCBA's Vice President of International Programs. NCBA also has a project doing more traditional microfinance in Egypt through its NGO partners. While successful, this project is seen as an "outlier" in NCBA's experience (It is urban, off-farm, non-cooperative) and will not be replicated elsewhere.

Besides its work in linking its clients to credit, NCBA provides business development services in production, processing and marketing. Much of this work is based on traditional extension workers teaching basic business skills such as accounting, market analysis etc. Another important area of intervention for NCBA is to provide support to the production and marketing (often export) of non-traditional agriculture. In El Salvador, Nicaragua and Indonesia, has worked with farmers in introducing certified organic products, particularly coffee. In El Salvador alone, over \$35 million of organic coffee has been sold by 69,000 farmers. In Indonesia, over \$300 million of foodstuffs have been exported by NCBA supported cooperatives to the US, Europe and Japan. In each case, there has been huge growth in income and employment.

NCBA faces the following issues and challenges:

- Overcoming its dependency on USAID. During the interview for this study, NCBA volunteered that previous Cooperative Development Program grants were vital to maintaining their core staff. This is particularly true since they are a 501- C6 (a non- tax- exempt organization) which makes it harder to raise money from the US public. Core grants have allowed them to both establish a model and write unsolicited proposals to disseminate it. NCBA is using the current Cooperative Development grant to try to diversify its source of support.
- Ensuring that indigenous CDOs it establishes are strong and financially sustainable in order to carry out cooperative development activities in their own countries post- project. This true not only of the country-level organizations, but of the Pan African Organization for Sustainable Development, POSDEV, the Africa region-wide institution as well. This will allow mutual support among countries and technical sharing regarding the NCBA approach. Fifteen ICDOs in 11 countries are currently receiving support from NCBA, recovering costs

- on a fee for service basis, and attracting donor money from a variety of sources. In Niger ICDOs have received 28 contracts in three years and have a \$20,000 operating reserve.
- Further examining the potential of group owned service businesses. While this does not directly affect the field of microenterprise, it has major implications for other sectors in which USAID functions such as health and natural resource management. Village managed and financed pharmacies and clients have been sought without much success by donors for a long time.
 - Dealing with the issue of second-tier co-ops. As with credit unions, national cooperative federations in Africa tend to be corrupt and inefficient or defunct. Yet, increased leverage beyond the primary societies is often necessary to capture additional value-added.
 - Examining the marginal costs of adding functional literacy components to their projects. NCBA maintains that basic literacy is necessary to ensure good governance and transparent management of cooperatives, particularly in places like rural West Africa. This harkens back to early debates on minimalism versus an integrated approach. It is also related to the more recent debates in microfinance on credit with education. While literacy has a more direct economic impact on the business than health or family planning, NCBA may be able to use its years of experience towards contribute to the discussions.

Land O'Lakes (LOL)

LOL Inc. is a fully integrated food processing, marketing and agricultural supply cooperative. It was organized in 1921 to improve the marketing of dairy products by local cooperative creameries. Since that time it has grown into a business owned by more than 300,000 farmers and ranchers and 1,000 co-ops in 27 states that has more than 6,000 employees. LOL has combined sales in excess of \$10 billion annually around the world. This makes it a Fortune 200 company.

This size and the fact that it is a functioning business rather than an apex or membership organization, make LOL unique among the CDOs studied. Land O'Lakes is a market and customer-driven cooperative committed to maximizing the value of its members' dairy, crop and livestock production. While many PVOs and CDOs seek to operate in a business-like fashion, LOL is a business. As a result, it actively explores commercial opportunities overseas including joint ventures, strategic alliances and direct supply agreements.

Aside from its development intent, LOL works with like-minded cooperatives that have the possibility to be strong business partners. Over time, LOL has opened commercial offices in Poland, Taiwan and Mexico. USAID should continue to take advantage of situations in which Land O'Lakes dual development and commercial agenda coincides with its own goal of broad-based, sustainable economic development.

LOL has been involved in international development for many years. Initially, this work was conducted through other CDOs with which it was affiliated. Gradually, LOL started providing training for overseas cooperative leaders in the US. As its experience grew, LOL established its own International Development Division and started accessing USAID grants directly. This

division has grown exponentially since its inception in 1983. Land O'Lakes has been receiving Cooperative Development grant funds since 1986. As pointed out in the evaluation of the grant program (Boyle), the International Development Division of LOL is a non-profit operation that cannot subsidize its business development efforts. Therefore, the core grants have been extremely useful. Also according to the evaluation, grant funds have had a highly leveraged return.

Despite LOL's demonstrated capacity to help farmers capture value-added, increase income and contribute to economic growth, the focus of its work has actually been nutrition. The rationale is that families feed children first, then increase surplus and value-added for income. While the poor are not always specifically targeted, they are always beneficiaries, and poverty is always part of the project design process. To accomplish its purpose, LOL works to create improvements in four areas: access (to inputs, credit and technology), choice (self-determination through joining with other farmers to maximize joint interests), competition (improving incentives and getting the government out of the private sector), and control (through increased knowledge).

This generally involves assistance to cooperatives. While LOL doesn't always start with formally registered co-ops, nine times out of ten it winds up working with some sort of co-op or association. Sometimes, however, this comes relatively late in the process and the groups don't refer to themselves as coops (As mentioned in reference to NCBA, in some countries in Eastern Europe and Africa, cooperatives have a bad reputation).

LOL lists over 30 areas of technical expertise in its corporate capability statement. This accounts perhaps for the broad, diffuse technical content of their program portfolio. Programs are, however, united by containing four key interventions: sector needs assessments, short and long-term technical assistance, in country customized training and US-based short courses and internships.

Before starting any program, LOL conducts a sector needs assessment. This involves heavy data collection in cooperation with host-country experts. The final assessment document includes a comprehensive description of the agricultural situation, a detailed list of constraints to development, and a recommended action plan for accelerated, sustainable growth in the sector. Land O'Lakes own business and marketing experience often leads to an industry-focused approach in which producers are effectively linked to processors. In fact, business linkages, technology, banking and finance, strategic alliances and labor are often networked across borders leading to a regional approach.

Long-term technical assistance is generally provided by project advisors who are available for a period of six months to several years. Long-term TA involves a series of activities that are intended to be replicable and sustainable. Short-term TA focuses on immediate change and impact on the recipient's business and last from a period of one week to one month.

Training is also a key element of LOL's approach. LOL's current strategy involves a pool of cooperative specialists simultaneously training staff from indigenous cooperative partners and

staff from the International Development Division (IDD). This will result in an in-house cooperative development capacity. The IDD staff will then continue to train indigenous counterpart cooperative leaders, transferring the skills from IDD to indigenous institutions in each of the regions in which it operates. The idea is that the newly formed regional cooperative development expertise will be self-sufficient in the delivery of development services and will have the capacity to respond directly to requests for cooperative support services beyond the period of LOL intervention.

To facilitate this process and lessen dependency on USAID, LOL has launched a wholly owned for-profit subsidiary, Advanced Business Concepts International (ABCI). The goal of ABCI is to develop, market and implement commercial business consulting services that lead to the profitable growth of ABCI and the establishment of commercial relationships. ABCI will market its services to cooperatives that have received USAID-funded technical assistance in the past. This will lead to a sustainable flow of technical assistance on a fee for service basis.

Creating access to short-term credit is also a feature of LOL's approach. Land O'Lakes uses a variety of mechanisms to facilitate such support: creating revolving loan funds (some capitalized by monetized milk), providing intermediation for loans from existing institutions (e.g. credit unions, cooperative banks, Opportunity International, CRS, the SOROS Foundation etc.) and providing a line of credit to processors who on-lend to producers.

One repayment advantage is that the co-op can often deduct the members loan repayment at source. LOL has made a strategic decision not to have its technical extension workers directly involved in providing credit, as there is a concern that this can destroy the TA relationship. The Land O'Lakes cooperative uses its own US-based finance company as a source of technical expertise in choosing the appropriate credit methodology in each program instance.

LOL faces the following issues and challenges:

- Supporting the successful completion and gathering of lessons learned from its sub-grant to Health Partners in Uganda. While there is no direct tie to microfinance, this is a fascinating example of a cooperatively owned service business potentially providing solutions in another sector (health) where sustainability is a large issue. This work with creating prepaid health care plans through co-ops and self-insurance through employers appears worthy of study and dissemination.
- Deciding to establish in-house expertise on microfinance. LOL has done excellent work in economic development. It has identified credit as a key constraint for the populations it works with and has worked with a variety of methodologies and partners. There does not appear to be, however, an overall strategy for facilitating access to credit. Despite the successful work the farm credit movement in the US has done, LOL's Finance Division is probably not the most appropriate source for such strategy development. LOL may want to create a position at HQ in microfinance if it wants to become more of a player in the sector, even if it a matter of making appropriate choices on credit to be provided by other institutions.

- Pursuing potential synergies with WOCCU. Many of the members of the co-ops LOL works with get credit from credit unions, some of the co-ops have actually gone on to start credit unions. LOL may want to have formal discussions with WOCCU concerning countries in which their programs overlap.
- Ensuring the attention, support and initial resources ABCI needs to allow it to become sustainable.

AAC/MIS

The Americas Association of Cooperative/ Mutual Insurance Societies (AAC/MIS) is an association of 35 cooperatively oriented insurance societies in 21 North, South, and Central American countries and the Caribbean. These companies have joined together to promote cooperatively oriented, group-based insurance throughout the Americas. In addition, the member institutions share their ideas and experience to better equip them to provide modern and competitive insurance protection for their members.

The primary program of AAC/MIS is to promote cooperatively oriented insurance by offering technical assistance and training to new and emerging member societies. The association responds to requests from cooperatives, credit unions and trade union movements throughout the hemisphere that desire assistance in forming their own insurance agency, department or company. In this work, the Association uses both its own funds and funds from government and private aid agencies.

The ties between insurance and microenterprise are strong and obvious. As pointed out in the monograph *Insuring Microenterprise*: “Microentrepreneurs need insurance to protect themselves and their businesses. Insurance can provide relief from the financial consequences of loss and backstop microfinance institutions. Similarly to microenterprise lenders, group-based insurance companies rely on delivery through groups to keep administrative costs down and to develop products that low-income people can afford. Like microenterprise loan funds which spread their risk with a large portfolio, insurance companies spread their risk through selling large numbers of policies. Many of the administrative challenges of small loans and appropriate insurance are exactly the same.”

Using a Microenterprise Best Practices grant from USAID, AAC/MIS (in collaboration with its member in Colombia, Seguros La Equidad) conducted market studies which confirmed a demand by microentrepreneurs for an affordable insurance package providing coverage for property (theft and fire) and employees (accident and health). Aside from support from USAID, the pilot effort is also being carried out in close collaboration with the Inter-American Development Bank and the World Bank.

Under the grant, AAC/MIS proposed to further expand and share the results of the pilot in Colombia to other AAC/MIS member companies and microfinance institutions. Many PVOs interviewed for this study (including FINCA and ACCION) touted insurance as the next major

service which MFIs must supply to their customers. The experience AAC/MIS has garnered is of major potential importance to the microfinance community.

AAC/MIS faces the following issues and challenges:

- Determining the appropriate lines of insurance to be included in any microenterprise insurance package. Currently, microentrepreneurs have been insured as members of pre-organized groups such as credit unions. As they are specifically targeted for their insurance needs, products must be designed to meet their unique circumstances. AAC/MIS surveys show that microentrepreneurs acknowledge the need for insurance. Policies just need to be tailored to their needs.
- Establishing strategic alliances in marketing insurance products for microentrepreneurs through cooperatives and microfinance institutions. AAC/MIS has made attempts to reach out to MFIs through workshops and brochures. These efforts continue to be important, not only as element of business development for its members, but as an opportunity to advance the field as well. MFIs need to better understand the complexities of insurance, and how insurance can better secure loans through reducing risks to individual entrepreneurs. Multiple uncoordinated efforts on the part of multiple institutions are not a way to move the provision of insurance to microenterprise along.
- Dealing with a growing need for microenterprise insurance with an institutional infrastructure that has remained intentionally lean and volunteer/consultant driven.
- Improving policy dialogue with government insurance regulators. Government regulations on capital requirements and the need to invest in government securities or particular sectors remain problematic for cooperative insurance providers. Attempts must be made to influence policies as appropriate.
- Dealing with the issue of the lack of access to re-insurance in some of the countries in which it operates.
- Supporting its members in countries where there is a lack of available capital to meet minimum capital to meet insurance company minimum capital requirements.

NRECA

The National Rural Electric Cooperative Association is a US-based membership organization of 1,000 consumer-owned electric utilities having over 60,000 employees, some \$62 billion in assets, and a grassroots constituency including the more than 30 million people who own these utilities. NRECA resources have been made available in over 50 countries over the past 35 years with significant support from USAID.

The international focus of NRECA's mission has two sides: 1) to create sustainable and replicable means of satisfying the growing energy needs of billions of people around the world; and 2) to provide and expand access to its US constituency to participate in addressing a rapidly growing energy demand overseas. NRECA's international program has sent over 500 experts and volunteers overseas to assist in the creation of rural electric cooperatives. Over two dozen

“sister cooperatives” relationships have been set up, and equipment worth millions of dollars have been donated and shipped overseas to support these efforts.

Effective working relationships have also been established with major non-USAID funding organizations like the World Bank, which are giving new attention to rural electric cooperative approaches and funding support. As a result of this work, more people receive electricity from these utilities today (an estimated 35-40 million people) than receive service from NRECA member cooperatives in the US.

As the overseas systems supported by NRECA have matured, NRECA has started to take on a different role. Instead of assisting in the establishment of a lot of new cooperatives, it is working increasingly to help existing cooperatives and their counterparts in the public sector with a host of “second generation” problems. These problems include systems loss reduction, cooperative involvement in ownership and or management of generation and transmission facilities, and cooperative involvement in renewable energy projects.

One tie of electrification to microenterprise is “productive uses”. There is an obvious connection between access to power and the capacity to make products better, faster and cheaper. Productive uses programs increase the use of power and thus strengthen the co-op. They also serve a social purpose in raising income for the poor. An evaluation of the El Salvador Rural Electrification Project showed that the project generated \$51 million in 12,000 microenterprises and 40,000 new jobs. It also resulted in 937,000 women days of labor saved through the use of electric gristmills and 156 thousand hours a year grinding and mixing grain and corn. Similar benefits have been gained in other projects.

A second tie between electricity and microenterprise results when credit is used to encourage productive uses. In Bolivia, for example, a loan program was arranged through PRODEM to provide credit to the end-users of electricity. In some cases the utility simply finds an appropriate intermediary. In other cases, it provides credit directly.

In some cases, co-ops have been able to add loan payments to customers’ bills. This makes credit administratively simple and virtually guarantees repayment.

NRECA faces the following issues and challenges:

- Making a success of its work with the Consumer Finance Corporation. Cooperatives are viewed as having the potential for increasing private participation in the economic restructuring in electric utilities as well as extending electrification to new areas. Yet, electric cooperatives in developing countries do not have easy access to private capital markets. The question of how to capitalize is a key issue. In an environment of deregulation and privatization, the longer-term prospects for cooperative electric utilities overseas depend on their ability to compete for market share and resources, including capital. They must build greater capacity for developing innovative private capitalization strategies and resources in order to expand their role.
- Contributing to making linkages between electrification and development of the microenterprise sector more visible and valuable. NRECA personnel are frequently called on to provide expert opinion on topics such as rural energy technology options and selection,

market and trade conditions for US rural electrification technology, the socio-economic impacts of rural electrification and evaluation modeling. NRECA could also leverage its information on impact in rural communities and contribute to the recognition of the need of the rural communities to access other resources (e.g., credit, and business development services) in order to make the use of electrification productive. There is a tremendous opportunity for joint efforts between the microfinance community and the electricity providers.

National Telephone Cooperative Association (NTCA)

NTCA is a non-profit association representing 500 small rural telephone cooperatives and locally owned and operated telephone companies. NTCA operates in the following areas:

Creating Telephone Cooperatives:

- Working with communities to help them develop their own telephone cooperatives
- Creating community telecenters to increase access to communications by all segments of rural communities
- Creating cooperatives to manage internet connections
- Creating municipal or consumer-owned systems where co-ops are not legally possible or financially feasible.

Technical Assistance to Other-Sector Cooperatives:

- Helping existing cooperatives in other sectors (e.g., agriculture) increase their access to modern telecommunications, and so become more efficient.
- Increasing rural communities and cooperatives' access to Internet facilities.

Building Partnerships:

- Bringing together local and US partners. NTCA has a variety of public and private sector partners, both domestic and overseas. U.S. partners include among others Netel, Price Waterhouse LLP, Bell Atlantic, Rural Telephone Finance Cooperative, National Exchange Carrier Association.
- Facilitating communications with and through local partner organizations be they cooperatives or other institutions with a stake in rural communications development. These include NGOs, local and regional governments, state monopolies, national regulatory and legislative bodies and investors.
- Serving as an honest broker between co-ops or communities and government offices, manufactures, consultants, financiers and suppliers.

Technology Transfer from the U.S.:

- NTCA relies heavily on volunteers to carry out technical assistance and some formal training. Managers from NTCA member cooperatives and professionals from associate member companies make up the majority of volunteers.

Financing Mechanisms:

- NTCA promotes local cooperatives and therefore the ownership of the users of services. The subscribers must be willing and able to make a financial commitment to the telephone cooperative. Member equity is an important criterion in NTCA's projects.

NTCA faces the following issues and challenges:

- **Combining finance mechanisms:** NTCA has worked with various model of equity ownership. When a cooperative equity is not possible, other mechanisms have been developed to combine government funds, members' equity, and other investors. Members' equity was used to invest in stock company. NTCA has to systematize a variety of models
- **Learning and sharing lessons on ties to microenterprise.** While the conceptual tie between improved communication and strengthened microenterprise is clear, NTCA must study and systematically document this.

Acronyms

AAC/MIS – Americas Association of Cooperative/Mutual Insurance Societies
ACDI/VOCA – Agricultural Cooperative Development International/Volunteers in Overseas Cooperative Assistance
AIMS – Assessing the Impact of Microenterprise Services
AMPES – now called “Financiera Calpia”
BDS – business development services
BHR/PVC – Bureau for Humanitarian Response/Office of Private and Voluntary Cooperation
BRAC – Bangladesh Rural Advancement Committee
BRI – Bank Rakyat Indonesia
CARE – Cooperative for Assistance and Relief Everywhere, Inc.
CDO – Cooperative Development Organization
CFN – Corporación Financiera Nacional
CGAP – The Consultative Group to Assist the Poorest
CHF – The Cooperative Housing Foundation
CIDA – Canadian International Development Agency
CRECER – Crédito con Educación Rural
CUES – Credit Union Empowerment and Strengthening
DID – Development International Desjardins
EAP – economically active population
FED – Ecuadorian Development Foundation
FFH – Freedom from Hunger
FFP – Food for Peace
FIE – a PFF that evolved from an NGO into fully regulated non-bank financial Intermediary (Freedom from Hunger)
FINCA – The Foundation for International Community Assistance
IDB – The Inter-American Development Bank
IGP – Income Generating Projects
JNCU – Jesus Nazareno Credit Union
LOL – Land O’Lakes, Inc.
MFI – microfinance institution
MFN – The Microfinance Network
MIS – management information systems
NCBA – The National Cooperative Business Association
NRECA – The National Rural Electric Cooperative Association
NTCA – The National Telephone Cooperative Association
OCDC – The Overseas Cooperative Development Council
PERLAS – (or PEARLS) **P**rotection, **E**ffective financial structure, **A**sset quality, **R**ates of return and cost, **L**iquidity and **S**igns of growth
PFF – private financial funds (*fondos financieros privados*)
PRODEM – Fundacion para la Promocion y Desarrollo de la Microempresa
PVO/NGO – Private Voluntary Organization/Non-governmental Organization
RCPB – Reseau des Caisses Populaires du Burkina
ROSCAS – Rotating Savings and Credit Associations

SBEF – The Superintendency of Banks and Financial Entities (*Superintendencia de Bancos y Entidades Financieras*)

SEEP Network – The Small Enterprise Education and Promotion Network

TA – technical assistance

USAID – United States Agency for International Development

WOCCU – The World Council of Credit Unions

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